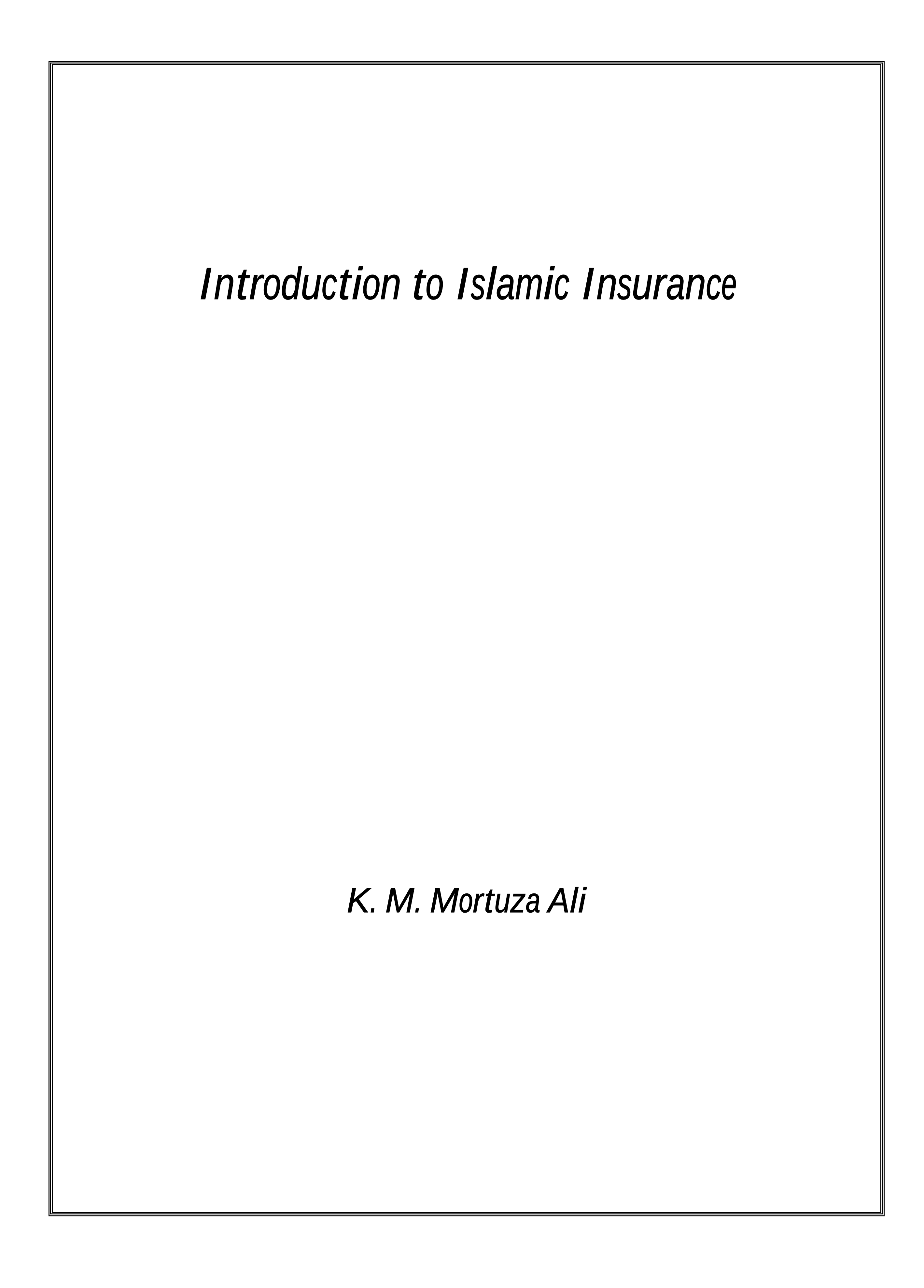
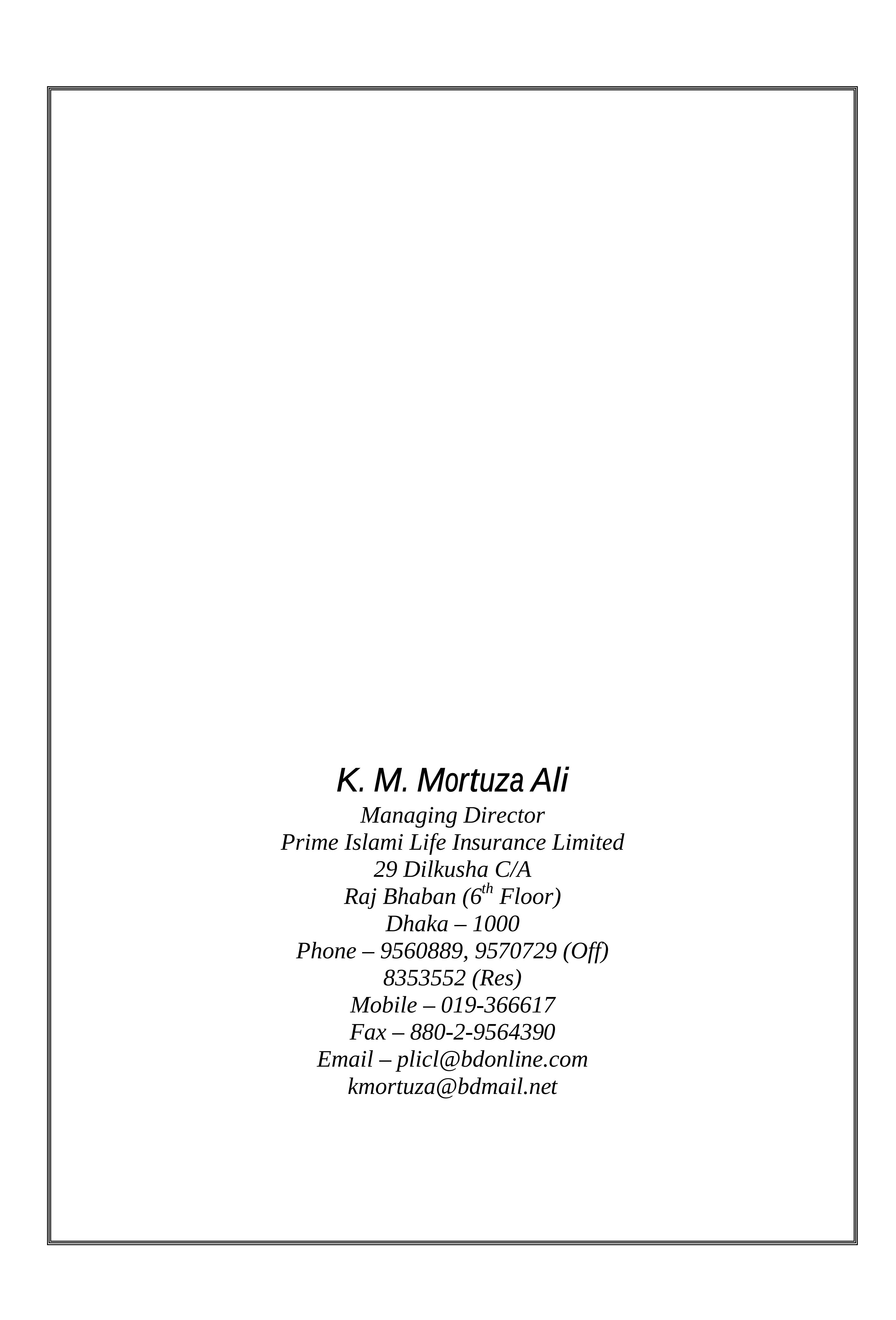


Introduction to Islamic Insurance

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Chapter (I)

Basic ideas about Risk & Insurance

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1. What is Risk?

Risk has been defined as the uncertainty as to the occurrence of an economic loss. It is the passivity of adverse result from a desired outcome. Risk and probability are not synonymous. We must understand the difference between risk and probability. The terms hazard and peril are closely related to probability than they are to risk. For example, collision is a peril which causes motor car accident and loss. The condition which makes the occurrence of collision more likely is called the hazard. For example, foggy weather is the hazard which creates the peril of collision. This means probability of collision increases when the hazard of foggy weather creates the peril of collision. Therefore, one can say that probability is the long run chance that out of a given number of possibilities, certain number of specific events will occur. But risk is the uncertainty as to occurrence of a loss. This is measured in the terms of degree of variation that actual events bear to probable events. The larger the number of exposures, the smaller is the risk. This is because under this situation, the smaller is the variation that actual events

bear to the probable events. This is called the law of large number. The greater the uncertainty, the greater is the risk.

2. **How do we distinguish between pure Risk and speculative Risk?**

The term pure risk must be distinguished with speculative risk. Pure risks are those which have the prospect of loss or no loss. But in a speculative risk the fear of loss and the hope of gain are both associated with it. The normal business risk is a speculative risk. However, the risk of fire is a pure risk. It is only the pure risk which is dealt with by insurance. Although risks of an individual are always uncertain and not measurable, it can be measured with the help of knowledge of the past occurrences by way of applying law of large number. Insurance for all purposes is a device to cover losses arising out of uncertain events. However, in General Insurance the premium or the price of insurance is certain and the measures of indemnity are also known both to the insured and the insurer. Therefore, the element of uncertainty in General Insurance is associated with only the happening or not happening of the event of the insured risks.

3. **How risk is handled?**

An individual is always concerned because of the uncertainties of life. He does not know whether or not a given loss will occur to him individually. For an individual, the risk is very large. This is simply because an individual can not obtain a sufficient number of exposures to have accurate predictions as to occurrence of losses. It is not the probability of loss which causes difficulty, but rather the uncertainly as to whether an individual will be among those who are expected to suffer loss. Had the loss been certain, one could perhaps prepare himself for it in advance. Since this is not the case, one should try to reduce risk through insurance and other means. One can handle risk by assuming it. Most of the people do it knowingly and unknowingly. In many cases we pass through life by way of accepting or assuming many small risks. However in many occasions one is to accept it simply because one can not afford to pay for its reduction or transfer. If one can afford to pay the price of risk transfer, the insurance company or some organization will bear the risk. In that case insurance company will bear the risk for a price. But how the insurance company will bear the risk? The insurance company handles risk by utilising the combination method as the basis of their insuring operation. The method of combination is the system of handling risk that usually involves the use of large numbers. The insurance companies persuade a large number of individuals, known as insured to pool their individual risks in a large group. When sufficiently large numbers are grouped the actual loss experience over a period of time will closely approximate the probable loss experience. The insurance company has little or no risk at all if this method is used properly. When all of the individual objects are pooled into one group, the risk is no longer present, if the requisites of insurable risks are met with.

4. **Why every risk is not insured?**

Insurance Companies do not cover all risks. That is to say, all risks are not insurable. Usually it is only the ‘pure’ risks which are insurable and not the ‘speculative’ risks. A pure risk can cause only loss but a speculative risk causes either a profit or loss. For example, there is risk in any investment and business venture due to market fluctuations. This is a speculative risk and, therefore, not insurable. However, a business man can insure the assets and legal liabilities against specified perils like fire, flood, cyclone, negligence, collision etc.

However, all pure risks are not insurable as there are many situations that can cause loss where the law of large number does not operate satisfactorily. For many situations large numbers of required statistical records are not available. If the insurers can not obtain

statistics over a sufficient length of time on losses resulting from a particular peril, they can not accurately predict the probable loss experience. In that situation it is not prudent to cover such risk. So it is evident that the prime requisite of insurable risk is that the number of objects must be of sufficient number. This means the probable loss must be subject to advance estimation in order that it can be made accurate the objects to be insured must be similar so that reliable statistics of loss can be formulated.

For example, in case of fire and theft insurance, commercial buildings and private dwellings should be grouped separately as the hazards against these risks are different. Similarly the properties situated in the cyclone bait should not be grouped with that of the properties located in the cyclone free zone. This means the physical and social environment of the group ought to be roughly similar. Therefore, it is evident that from the view point of the insurer one of the prime requisites of insurable risks is that the number of objects must be sufficient in number and quality so that a reasonably close calculation of probable loss can be made. Therefore, the insurers cover those risks which are pure and where the law of large number can be applied satisfactorily to measure the risks involved.

All risk are not insurable. This is mainly because there are many risks which in the true sense can not be termed as risks. Therefore, the authors of risk management have differentiated between pure risk and speculated risk. Normally the pure risk is insurable and speculative risk is handled by methods other than insurance. In pure risk, there is uncertainty as to whether the loss will occur or not but there is no chance of producing profit out of that event. But in case of speculative risk there is uncertainty of an event which could produce either a profit or loss. For example, a business venture and a gambling contract are the risks of speculative nature and therefore not insurable. Market risks such as price changes and or changes in the exchange rate of currency are not insurable. These risks are not subject to advance calculation, hence the insurer would have no realistic basis for computing his premium. Further, in times of rising prices no one would be interested to have insurance coverage against such risk and in times of falling prices an insurer can not afford to take on the risk because he can not avail the opportunity of spreading the risk over which to average out good years with bad years. The speculative risks are handled by the businessman by way of hedging, whereby a speculator assumes the price risk.

5. **What are the Characteristics of Insurable Risks ?**

In order for a risk to be insurable, its potential loss must have the following characteristics:

- the loss must occur by chance;
- the loss must be definite;
- the loss must be significant;
- the rate of loss must be predictable;
- the loss must not be catastrophic to the insurer.

The loss must occur by chance

To be insurable, the potential loss of the risk should be unexpected, unforeseeable and not intentionally caused by the insured. For example, the risk of a person being killed in an accident is fortuitous and is beyond the control of that person;

hence, insurance companies can offer Personal Accident policies to provide economic protection against financial losses caused by such accidents.

The Loss Must be Definite

The potential loss of an insurable risk must be definite in terms of time and amount. An insurer must be able to know when to pay a claim and how restricted is the period of cover granted to the insured. Therefore, he would expect to pay for losses which have occurred during that period.

The amount of claim to be paid depends on the type of insurance contracts issued. Basically, there are two types-contracts of indemnity and valued contracts. A contract of indemnity is one in which the amount of claim is based on the amount of financial loss as determined at the time of loss, subject to the maximum sum insured stated in the policy. Most general insurance policies are contracts of indemnity. For example, a fire insurer would indemnify the insured based on the actual property damage and losses caused by the insured perils. The insurer would pay up to the amount of the sum insured; the insured would bear the balance should the losses exceed the sum insured.

A valued contract is one that specifies in advance the amount of compensation that will be payable when a total loss occurs. The value is agreed between the insured and the insurer at the inception of the policy. If a total loss occurs, the amount payable is the sum insured. Valued policies are commonly issued for items such as paintings, sculptures, antiques and items of jewellery. For the sum insured to be agreed at the time of effecting the policy, a professional surveyor is normally engaged by the insurer to assess the value of the item to be insured. Examples of valued contracts are All Risks Insurance (for personal policy-holders)Personal Accident Insurance, and most Life Insurance policies, such as Whole Life, Endowment, Term etc.

The Loss Must Be Significant

It is common for people to lose things like umbrella, key pouches pen, pencils and sunglasses. Such losses are not apt to be very significant financially. Replacing an umbrella

does not cause financial hardship to most people. These types of losses are not normally insured as the administrative cost of handling such small claims could be so high as to lead to increased cost for such insurance protection and most people would find the protection uneconomical. On the other hand, some types of losses could cause financial hardships to most people. For example, a fire gutted a row of residential housing. The resulting home loss would be significant to the residents.

The Rate of Loss Must be Predictable

To provide compensation in the event of a specified loss, an insurer must be able to assess the chance of loss occurring or predict the probable rate of loss. These predictions of future losses would enable the insurer to determine the proper rate of premium to charge each policy-holder to ensure that insurers have adequate funds to pay claims as they become due.To predict the probability of loss, insurers use statistical analysis of past and current data gathered from various sources. Insurers also apply an important concept-the law of large numbers-to determine the loss probability. According to the law of large numbers, the larger the number of observations made of a particular event, the more likely

it will be that the observed results will produce and estimate of the "true" probability of the events occurring. By using the law of large numbers, insurers can predict fairly accurately the number of future losses that will occur in a similar group or units of exposures.

The Loss Must Not be catastrophic to the insurer

Where large numbers of people are subject to heavy risks or where there is a concentration of risks, the resultant potential losses could cause or contribute to catastrophic financial damage to the insurer. Such risks are not insurable as the principle that the losses of a few are borne by the contributions of many can not be applied here. Moreover, the losses could be too excessive and the insurer's accumulated insurance funds may not be sufficient to support them. For example, property damage caused by war. In such cases, governments oftenaccept responsibility for these risks.

6. **What are the requisites of Insurance for Covering Risk ?**

Requisites of insurance may be summarised as following:

a) Insurance must be effected by means of a legal contract and must meet the general requirements of contract as follows:

   i) It must be made by parties with legal capacity to contract.

   ii) It must be effected with a meeting of the minds of the parties.

b) For any insurance contract to be valid it is necessary to have insurable interest of the insured on the subject of insurance. This means an insured must suffer a financial loss to himself.

c) Property and liability insurance are subjected to the principle of indemnity which states that a person must not be indemnified more than his actual loss in the event of damage caused by a insured peril.

Principle of subrogation ought to be followed where the principle of indemnity is in existence. Under this principle, the insurer is entitled to subrogation which means they acquire the right to recover from liable third parties. This is necessary to reinforce the principle of indemnity i.e., to prevent the insured to receive more than actual loss.

7. **What are the Principles of Insurance contract ?**

Insurance is effected by means of a legal contract and must meet the general requirements of contract. Thus the insurance contract must not be against public policy, must be enacted by parties with legal capacity to contract, must be effected with a meeting of he minds of the parties and must be supported by a consideration. Insurance is a contract of adhesion and any ambiguities are construed against the insurer. The following legal doctrines are vital to the understanding of insurance contract.

<u>Insurable Interest</u>

A fundamental legal principle underlying all insurance contracts is the principle of insurable interest. This means insurance is operative only in respect of the interest of the insured in the event of property concerned and it is this interest which is the subject matter of insurance contract. It means it is not the bricks and materials used in building which is the subject matter of insurance. The subject matter of

insurance is the legally recognized relationship of the owner of the building, whereby he will, suffer loss if the building is caught in fire. This is essential, otherwise an individual would claim indemnification, even when he had not suffered any loss. The doctrine of insurable interest is also necessary to prevent insurance from becoming gambling.

Principle of Indemnity

The principle of indemnity ensures that a person does not get more than his actual loss, in the event of damage caused by an insured peril. It is important to note that only the contracts of property and liability insurance are subjected to this doctrine. Life insurance, health insurance and personal accident insurance policies are not contracts of indemnity (as no money payment can actually indemnify for loss of life or for bodily injury to the insured).There are several ways by which an insured can be indemnified i.e. by cash payment, repair, replacement and reinstatement. In every instance the onus of proving that the loss was caused by an insured peril rests upon the insured. The onus of proving that the loss was caused by other than an insured peril rests upon the insurer.

Without application of this principle, the insured would be tempted to make profit out of the happening of loss. There would be a tendency in the direction of over insurance. There are, however, some exception to the application of this principle in property insurance. For example, in marine insurance, for commercial convenience, it is customary to issue 'valued' hull policies i.e. the insured value of a ship is mutually agreed between the insured and the insurer. In the event of loss, the indemnity is measured by the value fixed by the policy.

Principle of subrogation

This principle states that the insurer, if and when indemnifies the insured, is entitled to recover from third party liable for the loss. One of the important reason for this doctrine is to reinforce the principle of indemnity i.e. to prevent the insurer from collecting more than his actual loss. Another reason for subrogation is to hold premiums below what they would otherwise be. This, however, does not allow the insurer to lodge claim against the insured, even if the insured is negligent. The principle of subrogation also does not apply to personal accident and life policies.

Principles of Utmost Good faith

This principle imposes a higher standard of honesty on parties to an insurance contract. The proposer must disclose before the contract is concluded all material facts which he knows or ought to know. Failure to make such disclosure renders the contract avoidable at the insurers option. It is important to note that avoiding the contract does not follow unless the misrepresentation is material to the risk. It is generally held that even an innocent misrepresentation of a material fact is no defence to the insured, if the insurer elects to avoid the contract. The insurer, however, in good faith pay claim even if there is breach. Breach of warranty may also be waived by the insurers. However, unless it is waived, a warranty must be complied with strictly and literally. It makes no difference whether the breach of warranty is material or immaterial, fraudulent or innocent.

8. **What are the different types of Life Insurance policies ?**

Life assurance contracts available are many and the basis of all these policies can be found under the following headings:

Term Insurance

This is the simplest and oldest form of assurance and provides for payment of the sum assured on death, provided death occurs within a specified term. Should the life assured survive to the end of the term then the cover ceases and no money is payable. This is a very cheap form of cover and suitable, for a young married man who wants to provide a reasonable sum for his wife in the event of his death. It can also be used for a variety of specific purposes such as business journeys.

Whole Life Insurance

The chosen sum assured is payable on the death of the assured whenever it occurs. Premiums are payable throughout the life of the assured or until retirement of the assured. Although premiums may cease at , say, age sixty the policy is still in force and should the person die at age seventy-five the policy would provide the benefits for his widow or family.

Endowment Insurance

The chosen sum assured is payable at the end of a given term of years or on earlier death. These contracts are taken out as savings plans for the future with the added attraction of life cover being included. Endowment contracts are always popular because each proposer earnestly hopes that he/she will live to the end of the term and spend the proceeds himself/herself.

Annuities

When a person has a reasonably large sum of money and wants to provide an income for himself after he retires or at some other time he can approach a life assurance company and purchase an annuity. The annuity may start at once, when it is called an immediate annuity, or may start at some date in the future (a deferred annuity). Regardless of when it starts it can take various forms. It may provide an annuity for the life of the person, the annuitant, or it may be payable irrespective of death for a certain period, as in the case of the "annuity certain". The guaranteed annuity is similar in that it provides the annuity for a guaranteed period and thereafter until the annuitant dies.

Pension Schemes

These schemes are designed to provide an income at retirement. So far as insurers are concerned they may be asked to arrange a scheme, rather than a firm doing all the work itself. This involves collecting the premiums, investing them and paying pensions to retired work people. Many scheme on endowment policies with a group life insurance cover to provide benefits should the death of a member occur before retirement age, but there are different ways in which this can be done.

9. **How Insurance is different from Gambling ?**

Although it is common to confuse insurance with gambling, from economic and legal point of view gambling and insurance are two distinct matters. It is true that insurance company pay an insured a great deal more money than it has received in terms of premiums, but this does not mean that insurance is thereby a gambling contract. The very purpose of insurance is to eliminate risks, whereas gambling creates a new risk.

For example, ‘A’ & ‘B’ may agree that if the property of ‘C’ comes under fire. ‘A’ will pay taka 1000.00 to ‘B’ and if there is no fire ‘B’ should pay taka 100.00 to ‘A’. In this case before this gambling contract neither party had any risk of losing or gaining any money from this source. When ‘A’ & ‘B’ agree to above proposition, each party becomes subject to a new risk of losing money. Moreover, neither ‘A’ nor ‘B’ has any insurable interest on the property of ‘C’.

However, if an insurance contract has to be effected it is only ‘C’ who can effect a fire insurance for the value of the property and the insurance company will agree to indemnify ‘C’ to the extent of loss against a fixed premium. ‘C’ in this case in fact has exchanged a large uncertain loss for a small but certain loss called the premium. It is, therefore, obvious that insurance is not gambling. It is a means of eliminating pure risk. Insurance is not gambling for many other reasons which can be stated as follows:

a) A contract of insurance is bound by the general principles of the law of contract but a gambling contract is not enforceable at law. The purpose of having an insurance policy is to indemnify oneself against unforeseen loss and is mainly based on the principle of mutual co-operation. The fundamental principles of an insurance contract are consideration, insurable interest, utmost good faith and so on. These fundamentals and essentials of an insurance contract make it different from gambling.

b) The financial motivation of gambling is provided by the gain in the event of winning, while in the case of insurance it consists in the desire to have protection against loss. On the other hand, the amount received by the insured is not a gain. It is a compensation or financial aid after loss. The money that a gambler wins is a profit. But in insurance, there is no element of profit.

   A pertinent question is that whether an insurer is guilty of wrongful devouring of the money of the insured. This may happen when the insured does not get back his premium if claim does out occur. Some scholars are of the opinion that insurance premium is in fact a price against a service. The insurer promises to provide security against possible loss of property. The contract of insurance is a contract of indemnity. Since there is no loss, there cannot be an indemnity. The premium, therefore, should be viewed as cost of services. It cannot be considered as wrongful devouring. It is totally different from the money earned from gambling. The owner of a casino house or the sponsors of horse race for betting do not render any service to the gambler and or to the society. On the other hand insurers provide an essential service to individual as well as to the society at large.

c) Insurance is not a game of chance. The amount of money required to meet the likely future claims can be measured by applying the law of large numbers. It is possible to calculate the average number of motor accidents, fire losses etc. per year. Actuarial science is verily applied to accurately measure the long-term liability of life insurers. Mortality table, morbidity rates are prepared on the basis of past statistics. This means, although the loss is uncertain or unknown to an individual, but the insurer can predict it in order to calculate premium based an probable losses against risks they underwrite. This is the reason why an insurance contract deals with pure risks and not the speculative risks. Insurers can predict and calculate

the amount of losses as they take into account of the group as a whole faced with particular and pure risks. Speculative risks are not accurately predictable and, measurable and therefore, not insurable.

d) There are several other differences between gambling and insurance contract. For example, applicability of insurable interest is a fundamental requirement for an insurance contract. This means without having any insurable interest on the subject matter of insurance, no one can effect the contract. Generally, the insured must have insurable interest at the time of loss of the subject matter of insurance . This makes the contract of insurance legally binding. But in case of a gambling contract, the gambler is not supposed to have any interest on the subject matter of insurance. The gambler is not interested to protect the property. His is not concerned about the security aspects of the subject matter and, therefore, not interested to improve the risk. The gambler hopes that the event he bets against will occur and he will make profit without any effort on the happening of that event.

On the other hand when the insured buys an insurance policy, he does not want that there should be an accident on his motor car or a fire should cause loss to his property. Insurance cover is purchased to protect the property. This is done as a precautionary and security measure. The gambler is motivated by the hope of financial gain, but the insured is motivated by the desire of financial protection against the possibility of a loss. Insurance cover is necessary to protect the property from the existing pure and particular risks. This is a means of mitigating loss, but a gambler always creates the risk. He willfully seeks at risk which was not there. These risks can be avoided. On the other hand the risk of fire, accident, for example are always there, whether or not an insurance contract is made to mitigate those likely losses.

e) Last but not the least, gambling is not useful and desirable to the society, whereas insurance provides a valuable service to the society, therefore, is desirable. From the point of view of desirability and usefulness, one can conclude that insurance contract is not a gambling contract. Islam does not permit gambling because it is not useful to the society.

10. **What is the main function of Insurance ?**

We all know that life is full of uncertainty. We can not avoid the risks in life and hence insurance. This is because insurance is considered to be the most effective and economic way of dealing with risks. Insurance, in fact, combat the risks in life by methods which are other wise not available. The principal function of insurance as an economic institution is the equitable distribution of the financial losses of the few over the many. In insurance, each policy holder contributes an amount in commensurance with the risk he introduced to a fund, established and administered by the insurer and out of the fund, the losses are paid to the insured members. The main function of an insurance organization then becomes the management of the fund and the assessment of the equitable contributions to be made by the policyholders.

11. **What is the greatest value of insurance ?**

Insurance is a socio economic institution that reduces risk both to society and to individuals. This is done by combining under one management a large group of objectives so that the aggregate loss to which society is subject become

predictable. Insurance has scientific basis and is effected by legal contracts, under which the insurer for consideration promises to reimburse the insured for any loss suffered during the tenure of the contract. There are many social and economic values of insurance, but the greatest value lies in the benefits following from the reduction of risk in society. Insurance has the advantage as a device to handle risk and, therefore, it is necessary that its services be extended in order to bring about the greatest economic advantage to a given society. Insurance brings many benefits to an individual and to society as a whole. It enables the risks of financial losses to be transferred from the insured to the insurer. The knowledge that insurance exists to meet the financial consequences of certain risks provides peace of mind and anxiety is reduced. The indemnity and or financial aid is the most important social and economic benefit of insurance. It helps to restore the insureds who have had a loss to the same financial position as before the loss occurred. This helps to maintain their economic positions and to ease the burden on others or on society as a whole.

12. **What is the Purpose of Life Insurance ?**

A human life has value for many reasons. We will be interested in discussing here the economic values only. The main economic problem which arises when someone in the family dies, is the loss of earning of the deceased person. In a business firm, if a key employee dies the firm may lose valuable customers whose loyalty depends on this individual. The value of human life, apart from death, may also be destroyed through loss of health by way of loss of earning due to disability and another peril which destroys earning capacity, just as premature death or loss of health. Because human life is recognized to have great economic value, a demand has grown for life and health insurance. As a social and economic device, life insurance is a method by which a group of people may co-operate to even out the burden of loss resulting from the premature death of members of that group. The purpose of life insurance is, therefore, primarily to accumulate wealth or property and even if death intervenes, to insure that the intended wealth will be available. Two distinct objectives of life insurance must be understood clearly. The first object is termed as “saving need” and the latter is termed as “protection need”.

13. **How insurance protects value of life ?**

The man economic problem which arises when someone in the family dies is the loss of earnings of the deceased person. In a business firm if a key employee dies, the firm may lose valuable customers whose loyalty depends on this individual. The value of human life, apart from death, may also be diminished through loss of health by way of loss of earning due to disability and expenditure for medical care. Old age is another peril which affects earning capacity, just as premature death or loss of health. The uncertainties of life are such that no man can say how long his life will last and every prudent and considerate person desires to make some provision for his dependants in the event of his death. The fundamental economic purpose of life insurance is to mitigate such possible loss. It covers the risk of death as well as meet the savings need when the benefit is payable in the event of survival.

14. **How Life Insurance schemes meet the saving needs ?**

The purchase of life insurance leads itself to a regular, consistent savings plan. The plan fits the psychological needs of many savers for a regular savings plan

with a semi compulsory flavour. As premium become due they are looked upon as any other bill and are more or less automatically paid. Annuity contracts are also used as means of savings. A life annuity is the reverse of the life insurance. It is often said that whole life insurance is insurance “against” dying too soon” and the annuity is insurance against ‘living too long”. As one can not know how long he will live after retirement, it has become an useful practice for many people to buy annuity. Under the annuity an insured receives a certain smaller income in return for an uncertain but larger income. When a person buys an annuity, he is agreeing that a portion of this estate shall be used for those who live long in return for the promise that if he should be one of the fortunate one to live long, he will receive contributions from those who die early. The usefulness of life insurance and annuity contracts as means of savings has been criticised by many as there are other superior methods of savings. One of the major criticisms has been that the inflation experienced in the economy eats away the value of those savings more quickly. It is rightly argued that over a period of time an average price level rises faster than the average income level and that the purchasing power of accumulated savings is thereby lessened. In order to combat this problem it has been proposed by some experts that a life insurance policy be issued with an automatic annual increase in the face amount and cash values to reflect and assumed annual rate of deterioration in the purchasing power of the money. However, such an insurance is not ordinarily available and not offered by the private insurers. Another alternative methods to deal with the problem has been through “variable annuity”. This method provides fund for a retirement income which would have a variable money value but a constant purchasing power. The operation of variable annuity method may be described in brief. Under this method a person should accumulate funds in equities and securities in the account of the insurer. The basic idea is that if the general price level rises over the accumulation period, the value of savings will arise, thus maintaining their purchasing power at a fairly constant level. If the general price level fails, the value of the saving will also fall, but their purchasing power will still remain constant. It is assumed that the value of the stocks at the end of a certain period would remain nearly perfectly adjusted to the rise in the consumer prime index. The insurer would express the accumulated fund in units of any arbitrary amount say 10,100 etc. For example, the stock value of taka 40,000 would be expressed as 400 units to taka 100 each. However, the value of each unit is recalculated every year to reflect changes in the value of underlying securities and the annuitant would be paid in term of their unit values. The main defect of this system is that it assumes that the stock market is nearly perfect reflection of consumer price changes which may not be true in all circumstances. In fact the stock market is a imperfect instrument in measuring changes in purchasing power. There will be some period when the value of the annuity may bear no resemblances to actual changes in prices. There exists a risk that if the annuitant retires at the time of a severe stock slump, he may not realise enough on retirement and thus suffer loss of substantial principal. Moreover, there is no guarantee that insurers who offer variable annuities will be able to achieve satisfactory investment results even in times when the general stock market index moves upwards.

The variable annuity albeit a radical departure form traditional life insurance contemplated so far, it is not an all cure method. However, it holds sufficient promise to warrant careful investigation and experimentation. In this context we will examine later the Islamic alternative of savings plan on Mudarabah basis.

15. **What are the social and economic values of Insurance?**

Dr. Mark R. Greene in his book "Risk and Insurance" has listed some of the social and economic values of insurance as follows:

i) The insurance reduces the amount of accumulated reserve fund needed to meet possible losses. For example, if each individual had to set aside such funds, he would need an amount far greater than the insurance company, because the individual not knowing precisely how much would be required, would tend to be conservative.

ii) The insurance mechanism encourage new investment. Thus insurance bring about a better allocation of economic resources and increases production.

iii) Since the supply of invisible fund is greater than would be true without insurance, capital is available at a lower cost than would otherwise be true.

iv) Because insurance is an efficient device to reduce risk, investors may be willing to enter fields they would otherwise reject as too risky. Thus society benefits by increased services and new products which are the hallmarks of increased living standards.

v) Because of adequate insurance coverage the entrepreneurs become better credit risk. In fact, today it would be difficult to borrow money from banks and lending institution for many business purposes without insurance protection.

vi) Insurance companies engage themselves in loss prevention activities. This is because insurers know that if no effort is made in this regard, losses would have a tendency to rise, since it is human nature to relax vigilance when it is known that the loss will be paid by the insurer.

vii) Last but not the least, insurance contributes to business and social stability and peace of mind by protecting business firms and the family breadwinner. When adequately protected, a business need not face the grim prospect of liquidation following an insured loss. A family need not break-up following the death or permanent and total disability of a breadwinner.

16. **What is the Actuarial Principle of Life Insurance ?**

The actuarial side of life insurance is the function of mathematicians. An actuary or mathematician with the help of mortality table can calculate the probabilities of death and survival. The actuary, by assuming a future rate of interest, calculates the present monetary value. This enables him to calculate the amounts required for reserves under various types of life insurance policies against future requirements. If the risk of death, within one year is known and then it is multiplied by the sum assured, the net premium requirements can be ascertained. The life insurance companies, makes a continuous mortality investigations so that mortality trends are always known to give proper guidance for premium calculations and keeping appropriate reserve fund.

17. **What is Reinsurance ?**

It is understood that in insurance the fund of the policyholders is managed by insurance companies and the losses incurred by a few are shouldered by many. Therefore, more the number of risks, lesser the possibility of loss incidence. In other words, wider the geographical spread of the business, better the result. The same basic principle applies to reinsurance also. Reinsurance is effected by an

insurance company to increase market capacity by spreading the risk over the international market. This is also effected to reduce any particular risk which the underwriters feel undesirable and must get rid of all or part of it. In order to do this, the insurance company takes the place of an insured and off loads its excess risks on another insurer. This is called reinsurance.

18. **What are the different methods of reinsurance?**

Reinsurance can be affected broadly by two methods:

(a) Facultative,

(b) Treaty.

Facultative reinsurance is affected only in special cases. Generally protection is obtained by a reinsurance treaty. Under treaty arrangement the ceding company agrees to cede during a specified period when the reinsurer agrees to accept up to a specified amount. The treaty is called “quota share” when the ceding company and reinsurer share each and every risk proportionately, on the original terms and conditions. In a quota share treaty the reinsurer, in effect follow the fortune of the reinsured. The treaty is called “surplus treaty”, when the ceding company by arrangement with the reinsurer cede only that portion of each and every risks which it does not like to retain in his own account. The “surplus” means the surplus over the amount of a risk retained by the company in its own account. The retention of a company is determined by maximum loss exposure of the risks undertaken, during the currency of the policy and the financial capacity of the company to bear such loss. Facultative reinsurance is placed on individual risk basis. Full information of each and every risk are required to be placed before the reinsurer, and the reinsurer, on receipt of these information’s decides whether to accept or decline the risk offered. The placement of facultative reinsurance is, therefore, uncertainty ridden and not usually preferred. However, when a reinsurance treaty is in existence, facultative reinsurance is effected to get rid of either excess over treaty limit or the part of or whole of an undesirable risk. An ‘excess of loss’ treaty is arranged when original underwriter bears all claims arising up to a specified amount and only when his ultimate net loss(after taking into account all recoveries) exceeds this amount, he can recover from his reinsurer up to a specified maximum. In this case, there is no proportional sharing of risks between the ceding company and the reinsruer. The reinsurer is absolutely liable for all ultimate net loss in excess of certain specified amount. The liability of reinsurer is, however, not unlimited, an upper limit is always fixed. “Stop loss” treaty reinsurance can also be arranged, whereby the reinsurer is not responsible for any individual loss, big or small, until the loss ratio for the year reaches an agreed percentage of the premium. When the loss ratio for the year exceeds this agreed percentage, the reinurer is responsible for all losses following beyond this percentage. The reinsurer’s liability continuers until the loss ration reaches an agreed upper limit. The purpose of ‘stop loss’ reinsurance is to limit the loss ratio to an agreed percentage of the premium income.

Whatever may be the method of reinsurance, it is to be understood that the more a country seeks reinsurance from abroad, it is importing service from abroad and there is outflow of foreign exchange. On the other hand, every time a country gives reinsurance cover to foreign risks, it is exporting its services abroad. Reinsurance cessasion to or acceptance from outside the country, therefore, have the same impact as our export - import have on our balance of trade. Therefore, it

is generally argued from national economic point of view, that the price of import of reinsurance has to be minimum possible.

19. **What are the weaknesses of conventional non-Life Insurance ?**

One can not deny the fact that insurance system has certain inherent weaknesses. For example, the benefits of insurance are achieved only at the expense of certain social costs. Therefore, we may look into those cost elements so that a comparative analysis can be made in order that one can have an impartial view as to whether Islamic insurance system can eliminate those costs to a great extent if not totally.

It has been estimated that annual overhead of property insurers account for about 30% to 50% of their earned premium. This means a major portion of the premiums paid by the policy holders would be used for doing the business and earning profit for the share holders. Therefore, it is obvious that the insuredes and the society obtain the benefits of insurance jointly against the cost of obtaining this service. However, it can be seen that the cost of operating the insurance business will be comparatively lower under the Islamic system of insurance. It is well understood that when the surplus (profit) is shared by the policy holder, the cost of obtaining the service would be lower in the Islamic Insurance (Takaful) system at least to the extent of surplus fund being returned to the policy holders.Secondly, the insureds in the conventional companies are to bear the costs for losses which are intentionally caused and or exaggerated. Although, there are no reliable estimates as to the extent of losses that are intentionally caused, it is obvious and insurers are well aware that good amount of claims are being paid against losses which are intentionally caused by some unscrupulous insureds in order to collect on their policies.

Thirdly, there is the tendency to exaggerate the extent of damage & losses that results from purely unintentional loss occurrences. There are lot of examples. When it is known that an insurance company is involved there seems to be an unmistakable tendency to exaggerate the extent of loss by surveyors, repairers, medical practitioners, solicitors as the case may be. This is done in collusion with the dishonest insureds.

20. **What are the objections against conventional life insurance ?**

There are various reasons cited by those who do not accept life insurance from Islamic point of view can be generally divided into three main arguments.

i) Gharar (Uncertainty)

ii) Maisir (Gambling)

iii) Riba (usury)

<u>Gharar (Uncertainty)</u>

This is defined as a contract in which the results, e.g. the compensation or benefit to be paid, depend on the outcome of future events that are not yet known at the time of signing the contract. This is prohibited under Shariah law. Unknown, uncertain or unclear factors, however, do exist in the operation of an insurance contract. There are such factors present, in one form or another, in every type of conventional life policy.

<u>Maisir (Gambling)</u>

The element of gambling arises as a consequence of Gharar. Examples include when a policyholder takes out a pure endowment policy. In so doing, he is taking a gamble that he/she will still be alive by the end of the term of the policy to receive the benefits stated in the contract. Some scholars, further, argue that the source of money that is to be used to pay for the benefits or compensation may come from non-Halal sources, as they are not determined.

Riba (Usury)

What constitutes riba is rather hard to define, as there has always been disagreement among scholars. However, it is generally agreed that the basic definition of riba refers to "interest" or 'usury'-the price paid in addition to the principal amount for the use of borrowed money or capital over a period of time. In addition to being tied to the amount of the loan and the time frame, its payment must also be guaranteed regardless of the outcome of the venture in which the capital is invested. As the underlying investment activities of many insurance company contracts are interest based, conventional life insurance policies, therefore, contravene the Shariah.

Chapter (II)

Fundamentals of Islamic Law and laws relating to Contract & Inheritance.

1. What is the basic concept of Islamic law ?
2. What are the main sources of Islamic Law ?
3. What is meant by the Shariah ?
4. How virtues of human being are classified in the Shariah ?
5. How vices are classified in the Shariah ?
6. How FIQh- (The Science of Islamic Law) is applied ?
7. What is meant by the Doctrine of Ijtihad(Interpretation) ?
8. When a contract is said to be void under Islamic Law ?
9. What is the basic concept of Al Gharar ?
10. Which Gharar is prohibited ?
11. Can Insurance Contract be termed as Maisir (Gambling) ?
12. Why the elements of uncertainty is not aollowed in Islam ?
13. Is there any element of Gharar in insurance contract ?
14. What are the Islamic Laws Relating to Mirath (inheritance) ?
15. What are the Islamic Principles of Wasiyah(Will) ?
16. Is there any restriction regarding Gift (Hiba) ?

1. What is the basic concept of Islamic law ?

Islam has a set of faith and values encompassing all aspects of life. Muslims are obliged to establish and maintain it. For example, Sovereignty, according, to Islam, vests in God. This means, it is only His Will that should prevail in this world. The Sovereignty of God implies the rule of the Divine Law as revealed by Allah, in the Quran to Prophet Muhammad (P.B.U.H) and as elaborated in the Prophet's "Sunnah". Man as vicegerent of Allah in earth can neither make nor abrogate the Divine Law. Man must necessarily submit to it if he realises that the All knowing God in His Great Wisdom is the best guide of man in all his affairs. Once the Sovereignty of God is recognised, the authority of its establishment is vested in the whole "ummah". "Tawhid" is the key concept in Islam . It sums up the Islamic way of life. The word in its literal sense signifies a relationship with the Only One that excludes a similar relationship with any one else. Tawhid is man's commitment to Allah. What Allah desires of man become value for him. Man who commits himself to the will of Allah, recognises no authority except His and accepts no guidance other than His. Tawhid implies that the universe has not come into existence without a creator, that there is a

creator and that He is one and one alone. He is the giver of laws for human beings. The whole human life, all its affairs and spheres are to be regulated in accordance with these laws given by him.

The view of life which Islam has presented is that this universe, which follows a set course of law and functions according to an intelligent and well laid-out plan is in reality the kingdom of one Allah. It is He Who created it, owns and governs it. Therefore, to the faithful, the Guidance and Law of God is the trust and most consistent attitude for mankind. It sets the standard for the orderly behavior of man both individually and collectively. Having once accepted the philosophy of life enunciated by the Quran and the Sunnah a Muslim must abide by the Islamic Law.

2. **What are the main sources of Islamic Law ?**

There are four main sources of Islamic Law. These are:-

(i) The Quran

(ii) The Sunnah

(iii) Ijma (Concensus)

(iv) Qiyas (Logical deductions from the Quran and the Sunnah)

The Quran and the Sunnah are said to form the fundamental roots of Islamic Law.

The Quran : The Quran is also called the Furquan, which means one showing truth from falsehood and right from wrong. In the Quran there are about five hundred verses which deal with legal principles. These legal verses embody broad principles. Since the Quran has no earthly source, it is obvious that none of this can be altered by any human agency or institutions. This is because every word of the Quran is that of Allah, communicated to the Prophet Muhammad. Sometimes, when the Prophet was faced with legal problems, he used to seek Divine guidance, and the answers which he received through Divine revelations formed a definite legal elements in the Quran. There are also many non-legal texts of the Quran which deal with morality and conscience and, therefore, have an effect on the legal science of Islam. The Quran gave the idea that the law is the direct commandment of Allah. Since He is one, His law must be single whole. The Quran says, "**It is not for the faithful, man and woman, to decide by themselves a matter that has been decided by Allah and His messenger, and whosoever commits an affront to Allah and His messenger is certainly on the wrong path"** (33:36) Muslims believe in the Divine origin of the Quran. Every word of this Holy Book is that of Allah, communicated to the Prophet Muhammad (P.B.U.H) through Gabriel (the angel).The Sunnah : The word "sunnah" means the "trodden path" which denotes some kind of practice and precedent. It means the practice and precedents of the Prophet Muhammad. The principles which were stated in the Quran found their application in the hands of the Prophet. This gave birth to Hadith. As a source of law, Hadith is as binding as the principles of the Quran. The Quran says, " **Whatever the Prophet gives accept it, and whatever he forbids you abstain from it**." (49:7) The successor of Prophet Muhammad (P.B.U.H) followed the practice of the Prophet. If they did not know of any decision of the Prophet on a subject, they made inquiries from the companions about it, and any of them informed them of any Hadith on the subject, they decided the case accordingly. They, however, always tested the reliability of the traditions. The Muslims have, in every age, after the death of

the Prophet Muhammad (P.B.U.H) been endeavoring consistently to ascertain what exactly his established "Sunnah" is, and whether any novel factor (bidat) was entering through some forged means. They did so, because it had the status of law for them. It formed the basis of judicial decisions in their law courts; and all their affairs, were being managed in accordance with it. Therefore, all the important orthodox Muslim Jurists are unanimous in upholding the validity of Sunnah as source of Islamic Law. Ijma: (consensus opinions) Ijma means, that all the Ulama (Knowledgeable religious leaders) of the Ummah have agreed upon a certain point. It is the agreement of Muslim jurists in any particular age on a juridical rule. The authority of Ijma as a source of law is founded in the Quranic text. The Quran says "**O ye who believe; obey God and obey the Prophet and those of you who are in authority and if ye have a dispute concerning any matter refer it to God and the Prophet**" (4:59). The validity of Ijma, as containing a binding precedent, is also based upon a Hadith of the Prophet which says that Allah will not allow His people to agree on an error. When it is established that there has been a concensus of the entire Ummah on a certain legal point, then it is not rightful for any person to refuse to accept that. This is so because the entire Ummah can not have concensus on error. Ijma has been classified into three types:

a) Ijma of the companions of the Prophet;

b) Ijma of the Jurists; and

c) Ijma of the people.

While the first type is universally accepted and is incapable of being repealed, the other two types are somewhat disputed.

Qiyas (Deduction by analogy) : Logical deductions for the Quran and Sunnah is the fourth source of Islamic Law. This is reasoning by analogy. It consists in applying to a matter with respect to which there is no clear guidance. There is a Hadith of the Prophet which is usually invoked in this connection. The Hadith says that the Prophet (P.B.U.H) fully approved of the replies of the Chief Justice of Yemen, when he said that in conducting the affairs of the court he would follow his own reason if and when the Quran and Sunnah do not give guidance to arrive at a decision. Qiyas has led to Istihsan (juristic preference). It means framing rules if necessary, in non-prohibited matters in conformity with the spirit of the Islamic legal system. The jurists found themselves compelled, in seeking solutions, to have recourse to reason, logic and opinion.

Therefore, Qiyas has been accepted as a definite source of law and it can not be easily over-ridden. But in the presence of a basis stronger than Qiyas, such as a text of the Quran, Hadith or Ijma, the Qiyas would be set aside and the stronger basis would be adopted through juristic preference or Istihsan. The setting aside of analogy in the presence of a stronger source is called Istihsan, which has resulted to an elasticity and adaptability to Shariah.

3. **What is meant by the Shariah ?**

It is Allah and not man whose will is the source of law in a Muslim Society. The Quran and the Sunnah prescribes a code of life for the followers of Islam, called the Shariah. The literal meaning of the Arabic word Shariah is "the way to the source of life" and, in a technical sense, it is now used to refer to a legal system in keeping with the code of behaviour called for by the Holy Quran and the Hadith. Muslims can not in goodfaith, compartmentalise their behaviour

into religions and secular dimensions. The entire life of a Muslim is governed by the Shariah. The Shariah prescribes directives for the regulations of individual as well as collective life. These directives reveal what is good and bad, what are the virtues and what are the evils. The Shariah is a complete scheme of life and an all-embracing social order. Islam signifies the entire scheme of life and not any part or parts thereof. Therefore, the Shariah can function smoothly and can demonstrate its efficacy only if the entire system of life is practiced in accordance with it and not otherwise.

Another important point to note about the Shariah is that it does not cover all the aspects of human life directly and explicitly. Among the aspects covered are those regulated in detail, as well as those very thinly covered, not going beyond a few guiding principles. Most elaborate is the coverage of the Shariah in matters relating to personal life, cleanliness of body and mind, keeping alive the remembrance of Allah through prayers etc. Then comes the family life and related socio-economic matters. Trade, commerce and finance come in for regulation through some specific but mainly general provisions.

Islamic law is only a part of a complete scheme of life (governed by the Shariah) and does not have any independent existence in isolation from that scheme. The scheme of the Shariah is, however, divided into many parts. There are some aspects of it which do not need any external force for their enforcement, those can be enforced only by the ever awake conscience kindled by his faith in a Muslim.

A very large part of the Islamic system of law, however, needs for its enforcement, in all its details, the coercive power and authority of the state. In modern parlance, it is only those injunctions and regulations which are backed by political authority are termed as law. But as far as the Islamic conception is concerned the Shariah stands as synonymous with law, because the whole code of life has been decreed by the All powerful Sovereign of the universe. It embraces many aspects that would not necessarily be considered as law elsewhere. Law and religion in Islam is so intimately connected that they cannot be separated. Shariah embraces both law and religion. The needs of the changing times have placed stress on the fabric of Islamic Law and Shariah has succeeded in preserving its basic character in the face of many odds and upheavals. Islamic law is rising because it has in built corrective mechanism. The main objective of the Shariah is to construct human life on the basis of Marufat (virtues) and to cleanse it of the Munkarat (vices). The term Marufat denotes all the virtues and good qualities that have always been accepted as good, hence desirable and obligatory. Conversely, Munkarat denotes all the sins and evils that have always been condemned by human nature as evil. The Shariah gives a clear view of these Marufat and Munkarat and states them as the norms to which the individual and social behaviour should conform. The Shariah does not limit its functions by providing an inventory of virtues and vices. It lays down the entire scheme of life in such a manner that virtues may flourish and vices may not contaminate Human life. One part of the Shariah has a permanent and unalterable character and another part is rather flexible and has thus the potentialities of meeting the ever increasing requirements of every time and age. The second part of Islamic Law is that which is subject to modifications according to the need and requirements of the changing times and makes it fully capable of fulfilling all the needs of an expanding human society in every age. The unalterable elements of Islamic Law are only those laws, directive principles

and limitations that have been laid down in explicit and unambiguous terms in the Quran or the authentic Hadith of the Prophet. It is these unalterable mandatory provisions of the Islamic Law which give a permanent complexion to the Islamic Social Order.

4. **How virtues of human being are classified in the Shariah ?**

The Shariah classifies Marufat (virtues) into three categories :

a) Fard & Wajib (Mandatory): Fard & Wajib represents the class of actions that is mandatory on every person claiming to be a Muslim. For example, praying five times a day, fasting, Zakah are among the compulsory actions that a Muslim must perform.

b) Mustahabb & Matlub (Recommendatory): Mustahabb & Matlub describes the class of actions that are not obligatory but highly recommended of Muslims. Example of such actions would include supererogatory fasting beyond Ramadan, praying the nawafil prayers, etc.

c) Mubah (permissible) : Mubah actions are permissible in the sense they are specified neither as mandatory nor as forbidden. For example, a Muslim may like a certain type of permissible food over another type of permissible food. Or a Muslim may like gardening, sports, travelling etc.

5. **How vices are classified in the Shariah ?**

The Munkarat (vices) have been grouped into two :

a) Haram (absolutely prohibited): Haram actions are unlawful and prohibited. Committing them is a major sin, e.g., murder, adultery, drinking alcohl. Such acts are likely to incur the punishment of Allah in the Hereafter as well as a legal punishment in this world.

b) Makruh (disliked): Makruh actions are not absolutely forbidden, but are detested. The Makruh is less in degree than the Haram and the punishment for Makruh is less than for those acts which are Haram, except when done in excess and in a manner leading towards what is Haram. For example, although smoking is not expressly forbidden like drinking alcohol, it is in itself a action that is Makruh.

Strictly speaking, everything which has not been expressly prohibited by the Shariah is permissible Marufat (Mubah). The recommendatory are those which the Shariah wants that a Muslim Society should observe and practice. On the other hand, it has been enjoined on Muslims by clear and mandatory injunctions to refrain totally from everything that has been declared Haram and Makruh are those deeds for which the Shariah signifies its dislike, therefore, those are condemned and discouraged.

6. **How FIQh- (The Science of Islamic Law) is applied** ?

The word “Fiqh” literally means intelligence. Technically, it means knowledge of Islam through its laws. This is also termed as science of the laws of Islam. It is the whole science of Islamic Jurisprudence and implies an independent exercise of

intelligence in deciding a point of law. Fiqh is based on the sources of Islamic Law. Fiqh generally deals with the jurisprudence i.e. the first principles for establishing their juristic validity. In Fiqh, an action is either legal or illegal.

Implicitly, what is lawful is also moral and what is unlawful is immoral. It is very important for Muslims to avoid the unlawful and to avoid making the unlawful as lawful. A Muslim should not get himself involved in any action which Allah has explicitly forbidden to do and for which he specified a penalty. Muslims also should not make unlawful what Allah has labeled as lawful. However relatively few things fall under the category of Haram (prohibited) or Halal (Legitimate). The Haram is prohibited to everyone alike. Even good intentions do not make the Haram acceptable. However, Haram under one set of circumstances may become permissible under others. Thus a Muslim is not allowed to eat pork. However, should he fear death from starvation, and nothing but pork is available, he is allowed to eat pork in that specific situation. To make lawful and to prohibit is the right of Allah alone. Human being can not prohibit the Halal and permit the Haram. Falsely representing the Haram as Halal is also prohibited. Allah Himself says in the Quran, "**Say: See you what things Allah has sent down to you for sustenance ? Yet you hold forbidden some things these of and (some things) lawful. Say: Has Allah indeed permitted you, or do you invent(things) to attribute to Allah**" (Quran 10:159)

The basic principle of Fiqh is the permissibility of things and prohibition of things is due to their impurity and harmfulness. Muslims must avoid all Haram actions, because what is halal is sufficient and what is Haram is superfluous. The eternal law of Islam is not limited to matters of religion; it permeates all aspects of a Muslims life. Islam actively encourages Muslims to get involved in trade, business, commerce and financial transactions. A Muslim is expected to participate in the worldly affairs with the provision that any material enhancement and growth must lead to social justice and spiritual upliftment of both the ummah and himself. While participating in this life, a Muslim must remember to be consistent both in his acts of worship and in his day to day life. Since a Muslim looks upon everything in the world is belonging to Allah, the same lord to Whom he himself belong, he should not be biased in his thinking and behaviour. The most important effect of "La ilaha illa Allah" is that the Muslim will obey and observe Allah's Law. He believes that Allah knows everything open or hidden, and that he can not hide anything, intention or act from his Lord. Consequently, he will avoid what is forbidden and engage in what is good and legitimate.

7. **What is meant by the Doctrine of Ijtihad(Interpretation) ?**

In developing Islamic Law by consensus the doctrine of ijtihad was employed. It denotes the exercise of ones reason to deduce a rule of Sharia law. It is based on the application of some distinct principles such as Istihsan (equity), consideration of public interest (Masalih al Mursalah) and istislah (sound precedent).

Ijtihad is an endeavour to formulate an overall view of life as the Law Giver would like it to be. Ijtihad is restricted to drawing of valid conclusion from the Quran, the Sunnah and the concensus by analogy or systematic reasoning. Islamic Law has been derived from the Quran, the Sunnah, Ijma, Qiyas, Istihasan etc. Interpretation or Ijtihad serves as a medium in deducing rules from these sources. In certain matters the Quran and the Sunnah have laid down clear and categorical injunctions. These injunctions cannot be altered, by any means. But, there are areas where academic research and intellectual efforts in seeking and arriving at rules from various sources of law is possible. This makes the legal

system of Islam dynamic. Ijtihad in the linguistic sense means the expending of effort. Technically it means maximum effort to ascertain the real meaning and intent of any injunction. The purpose of Ijtihad is to find out exactly and precisely what the law is and to investigate the conditions for which it is intended. The real law of Islam is the Quran and the Sunnah. The legislation that human being may undertake must essentially be derived from this fundamental law or it should be within the limits prescribed by it. The purpose and object of Ijtihad is to properly understand the Supreme Divine Law and to impart dynamism to the legal system of Islam by keeping it in conformity with the fundamental guidance of the Shariah. It consists in legislating on matters for which neither any explicit injunctions nor even precedent exist, subject, of course, to the general principles and precepts of the Shariah.

8. **When a contract is said to be void under Islamic Law ?**

Under Islamic law, a contract is said to be void under following circumstances:

a) When there is doubt as to the actual existence of the subject matter of the contract.

b) When the subject matter is in existence at the time of the contract but it may not be in existence later.

c) When the subject matter of the contract is in existence and likely to be available later, but the quantity and quality of such matter con not be precisely determined at the time of the contract.

d) When there is ambiguity in the contract language which may lead to uncertainty regarding the nature of the object of sale or price. This may happen, when one party offers to sale an item which is hidden and not known to the buyer. The seller does not disclose it and asks for quoting price for the unknown item.

From the essence of these circumstances of void contacts we understand that Gharar in a contract of sale is present where the buyer does not know what he is buying or the seller does not know what he is selling. This is an example of the sale of probable items whose existence or characteristics are not certain and which makes the trade similar to gambling. Therefore, Gharar is an ambiguity in the contract which can lead to an outcome that would not be acceptable to one of the parties if the party knew it in advance. This means a Gharar contract is one when the rights and obligations of the concerned parties are left imprecise or uncertain deliberately by one of the party with a motive of windfall gain or loss. This element of the Gharar contract resembles it with gambling contract.

9. **What is the basic concept of Al-gharar ?**

According to Hadith of the Prophet, (Sm) Al-gharar is prohibited in Islam, as a factor in business contracts. According to Islamic Jurisprudence, the element of uncertainty disqualifies a contract, if it is incorporated in a business contract and its effects can be very large and substantial. Gharar is objected to in any transaction because it is said to undermine the element of consent necessary for a valid contract. It would not be fair to expect that one party of the contract should give his consent to something when the essential elements are not known to him and or unclear. The Prophet was reported to have said, " It is not permissible to sell an article without making everything (about it) clear, nor it is permissible for any one (who knows about its defects) to refrain from mentioning

them". The concept of Gharar is very broad one. It may carry different shades of meaning in relation to different types of transactions. However, generally gharar means unclear or uncertain terms with regard to the subject matter of the contract. It means lack of transparency. Gharar is present in all those business dealings in which one party does not know what is in store for him at the end of a bargain. Gharar in business contract may be lack of information regarding any or all of the following:

(a) Quality, (b)quantity, (c) Price, (d) Terms of payment, (e) Nature of object (f) Prospect of delivery etc.

This means Gharar is mainly the uncertainty or lack of clarity surrounding the subject matter in respect of existence, availability, quantity, quality, price, date of completion and delivery of the subject matter. Knowing the subject matter in a contact is a necessity. This is because one can not or should not give his consent to something that he des not know. In the context of business contract, Gharar is related with uncertainty and consequent insufficient knowledge of the details of the contract which is likely to cause disputes. Islamic jurists, therefore, insist on a very clear statement of every possible detail affecting each party to a contract. However, there is difference in juristic opinion on the tolerable level of Gharar. A distinction is drawn between Gharar Yasir (minor uncertainty) and Gharar Fahish (excessive uncertainty). Islamic jurists have generally considered that socially desirable and indispensable transactions that can not be freed from uncertainty are permissible. In view of their usefulness, uncertainties in them are to be tolerated. However, there is difference of opinion regarding the permissible level of uncertainty.

In the absence of a clear explanation as to what constitutes Gharar, scholars have had to form their opinions through the process of Qiyas (analogy). Generally transactions based on ignorance and chance are considered as Gharar. The following are some of the examples of Gharar expressly forbidden by the Prophet (P.B.U.H)

a) Irrespective of the quantity of fish in the pond, its sale at a fixed price.
b) sale of the offspring of a still to be born animal
c) Sale of fruits in an orchard at the initial stage of fruition
d) Sale of goods by way of tossing, without giving opportunity to the buyer to properly examine the object of the sale.

It appears form the above examples of forbidden contracts that lack of clarity is involved in these transactions. These contracts are forbidden because they rely too much on chance. At the time of buying, the buyers can not know about the quality and or quantity of the item to be purchased. This ambiguity in the basic term of the contract makes it invalid in the eye of Islamic law. The reason why the Prophet prohibited Gharar in business contract is to ensure that one party of the contract does not have unfair advantage over the other. Gharar is prohibited, because Islam seeks to ensure justice and fair play in all business dealings.

10. Which Gharar is prohibited ?

It is observed that Gharar does not have a single definition and it is a broad concept. However, Gharar is considered to be of lesser significance than Riba. While the prohibition of Riba is absolute, under certain circumstances Gharar is

acceptable under the Islamic Framework. Riba is prohibited because it is a contract that contains certainty while real life is not certain. Riba is a payment that is sure and certain while real life is neither sure nor certain about the outcome of the use of capital. It is a risk-proof contract and that is why it is strictly prohibited. On the other hand Gharar is prohibited owing to doubt and uncertainty due to lack of information. There are a number of Hadith on this subject. It is important to note that information is central to the Islamic system of contracting. Absence of adequate and accurate information is a source of Gharar. There is difference in juristic opinion on the tolerable level of Gharar. A distinction is drawn between Gharar Yasir (minor) and Gharar Fahish (excessive). Islam does not prohibit those transactions that fulfill genuine needs and or indispensable for certain desirable ends. In view of their usefulness, uncertainties in them are tolerated. It is an accepted principle of Islamic Jurisprudence that necessity renders prohibitive things permissible. Minor Gharar does not render a sales contract defective, since no contract can be entirely free of Gharar. The reason why Gharar is prohibited is the fact that it leads to dispute, hatred and devouring others wealth wrongfully. The origin of the term Gharar is “Gharra” which means “to deceive”. Gharar is objected to in any transaction because it is said to undermine the element of consent necessary. Mutual consent and truthfulness of the parties to a contract is a basic requirement for a valid contract in Islam. If appears that the subject of Gharar mainly revolves round the issue of its magnitude, i.e. whether it is minor, moderate or excessive. In their evaluation of Gharar the jurists have been influenced by the prevailing circumstances, popular custom and their own vision and interpretation of public interest and necessity. The Prophet (P.B.U.H) enccouraged Muslims to indulge in business activities. In any business venture, there is the element of uncertainty, but it is not Gharar. Gharar may lead to risk, but the presence of risk may not necessarily be attributal to Gharar. Risk is a part of life. We can not eliminate risk because life is full of uncertainties. Islamic jurists have generally considered such socially indispensable transactions that cannot be freed from uncertainty as permissible. Gharar is prohibited when there is possibility of deceit, fraud and or deliberate misrepresentation.

11. **Can Insurance Contract be termed as Maisir (Gambling) ?**

The word Maisir means getting something for nothing, and when a person receives a windfall gain purely based on luck and without working, it is called Maisir. Islam prohibits all forms of business dealings where monetary gains come from chance, speculation and not from work. In the Quran the word Maisir has been used to denote games of chance. The word Maisir has been derived from “usr” i.e. ease and convenience. This implies that a gambler seeks to amass wealth without effort. Methods of gambling prevalent in pre-Islamic Arabia fall into the modern category of games of chance. Unlike Gharar, Maisir or games of chance(gambling) is not accepted at all by Islam. A transaction involving gambling is one where a gambler hopes for a material gain. It is alleged that an insurance contract has the elements of Maisir as the insured pays the premiums with the hope or a chance of a material gain in the form of a large amount of money. Therefore, it is alleged that an insurance contract involves the unlawful element of gambling.

However, jurists counter this allegation by arguing that the financial motivation of gambling is provided by the gain in event of winning. While in the case of insurance it consists in the desire to have protection against loss. The amount

received by the insured can not be considered as Maisir since it only provides him relief from the burden of loss that he has incurred. On the other hand, the money won by the gambler is in the nature of wind-fall gain, based on the game of chance. Moreover, the gambler in a transaction of gambling or betting is always hoping for a material gain in the spirit of defeating each other. In contrast, the parties in a contract of insurance are bound together in a manner of mutual cooperation and goodwill to provide security against unexpected future loss. An insurance transaction is based on the principle of trust, whereby two parties (insurer and insured) engage in an agreement in which one of them deposits money to the other as a trust (amanah) for future safety. This is permissible in Islam as the Quran commands the believer to render back the trusted amount to those to whom they are due(the Quran 4:58). An insurance contract does not create an opportunity for the insured to hope for a chance for a material gain. In fact, it is a transaction whereby the insured takes an initiative to the best of his ability to be compensated in the event of an unexpected loss. Such compensation has been mutually agreed by both the insurer and the insured. Thus the contract of insurance signifies the element of mutual cooperation and not gambling. An insurance contract is based on the principle of donation . The insured in a general insurance(non-life) contract pays premium for the purpose of getting compensation in case of unexpected loss or damage. If there is no loss, the premium will be considered as donation for compensating the loss of others. In case of life insurance contract, the insured pays premiums like a gift for the welfare of his dependents. This is an initiative to look after the welfare of the dependents who may have suffered otherwise. It is verily justified and desirable from Islamic point of view; as Allah has always wished for a good and convenient life for His creatures, not wishing them to face any difficulty. The Quran says to this effect, **“ .... Allah intends an easy life for you while He does not want to put you in difficulties**” (The Quran 2: 185).

In this respect, the Prophet said, “ Whosoever takes an initiative (towards the welfare of) ones financial difficulties, Allah will lighten his difficulties in this world and in the hereafter. He also said that, “ It is better for you to leave your offspring wealthy than to leave tham poor, asking others for help”. (Narrated by Abu Huraira and Saad Bin Salim Abi Waqas).It is alleged that the gambler as well as the insured could receive huge amount of money, without equivalent input from their side. It is true that an insured may get a great deal of money than the premium he has paid, but this does not mean that insurance is thereby a gambling contract. It is to be noted that the very purpose of insurance is to eliminate risks, whereas gambling creates new risk. Insurance is a means of handling risk carefully. Insurance is considered as the most effective and economic way of dealing with risks. In insurance the law of large number is always the guiding factor. This characteristic of insurance is very important to understand. The price of insurance which is called the premium is determined on the basis of scientific calculation of probable loss. Therefore, the premium which an insured pays to insurer is based on statistical data, mortality rate etc.The principal function of insurance as an economic institution is equitable distribution of the financial losses of the few over the many. In insurance, each policyholder contributes an amount to a fund in commensurance with the risk he introduces. The fund is managed and administered by the insurer and out of that fund the losses are paid to the insured members. The basic theory of life insurance is that all who pay life insurance premiums to the common fund do so with the willingness that the fund should be used to compensate the estate of those

contributors at whatever age in life they may die. Life insurance is a method by which a group of people may cooperate to even out the burden of loss resulting from the premature death of members of that group. The uncertainties of life are such that no man can say how long his life will last and every prudent and considerate man desires to make some provision for his dependents in the event of his death. The purpose of life insurance is, therefore, to accumulate some wealth and even if death intervenes, to ensure that the intended wealth will be available. The nature of life insurance policy is similar to that of a retirement provident fund and or pension scheme. Where pension schemes are allowed in Islam(provided these are riba free), there is no reason why insurance scheme should be treated as gambling.

12. **Why the element of uncertainty is not allowed in Islam ?**

Although Muslims are encouraged to do business, they must do so by mutual consent and not to make money by unfair and unlawful means. The Quran states :

"O believers ! do to devour one another's property by unlawful ways; instead do business amongst you by mutual consent."

Gharar is objected to in any transaction because it is said to undermine the element of consent necessary for a valid contract. Indeed how can there be mutual consent when one party, because of inadequate information, does not have the correct impression of the material aspects of the contract. It would not be fair to expect that party to consent to something of which the essential elements/aspects are not known. Mutual consent and truthfulness of the parties to a contract is, therefore, a moral obligation and a basic requirement for a valid contract in Islam. In a translation of a hadith, the Holy Prophet was reported to have said: "*it is not permissible to sell an article without making everything(about it) clear, nor it is permissible for anyone who knows (about its defects) to refrain from mentioning them."*

Insurance practitioners and students would find the above familiar as it is similar to the insurance principle of Uberrimae Fides (Utmost Good Faith). In the case of Carter vs. Boehm-1766, Lord Mansfield said the following:

"*Insurance is a contract upon speculation. Good faith forbids either party by concealing what he privately knows, to d raw the other into a bargain, from his ignorance of that fact, and his believing to the contrary"*.

One difference is that the duty of disclosure in Islam is applicable to all commercial contracts and not only to insurance contracts. Viewed from the historical perspective, the requirement of Utmost Good Faith by the Holy Prophet preceded western laws by more than 1,000 years. It is only in recent times that we hear calls for greater transparency in the western world. The Unfair Contracts Terms Act 1977 (UK) for example, is a relatively recent development.On the authority of a hadith, the Holy Prophet was reported to have forbidden all transactions involving gharar without defining it. In the absence of a clear explanation as to what constitutes gharar, scholars have had to form their opinions on this subject through the process of qiyas (analogy)based on the Qur'an and other Sunnah of the Holy Prophet. For example various types of transactions and exchanges of property practised by the jahiliyah (pagan Arabs)before the advent of Islam were approved or prohibited by Holy Prophet. These became precedents and served as broad guidelines for future Muslims. The

following are examples of some transactions involving gharar expressly forbidden by the Holy Prophet upon which some scholars base their opinion on gharar:

1. *Habal al-habalah*- sale of the offspring of a still-to-be-born animal;
2. *Mulamasha*-sale of fruit prior to ripening;
3. *Bai'munabadha*- a sale performed by the vendor throwing a cloth at the buyer and achieving the sale without giving the buyer the opportunity to properly examine the object of sale;
4. *Al*-madhamin wa'l-malagih-sale of what was in the loins and wombs;
5. *Bai Al*-hassat- a type of sale where the outcome is determined by the throwing of a stone. For example sale of cloth where the customer is asked to toss a stone. The cloth on which the stone lands is the one bought for a particular price.

The above contracts were forbidden perhaps because they rely too much on chance. At the time of buying, the buyers did not even know the quality and/or quantity of the item being purchased. These will only be known later, say after the fruits have ripen or after the stone has landed, by which time there could be dispute and ill-will. The element of uncertainty (gharar) in the above contracts is such that it is akin to gambling. The concept of gharar is a very broad in that it may carry different shades of meanings in relationship to different transactions. For the purpose of our discussion gharar could simply be described as deficient clarity or uncertainty with regard to the subject matter ("Ma'kud 'Alaih") being contracted. Perhaps in modern parlance, gharar could be described as the lack of transparency in a given transaction. According to Ibn Taymiya, gharar is present in all those business dealings in which "one party does not know what is in store for him at the end of a bargain". If that is so, then undertaking anything blindly without sufficient knowledge or to risk oneself in a business venture without knowing exactly what will be the outcome or drawing up open ended contracts could all for example be regarded as gharar. Apparently gharar is not just about lack of information regarding the quality or quantity of the subject matter but according to Ibn Rushd, it may originate from:

- ignorance and lack of information over the nature and attributes of an object;
- doubt over its availability and existence;
- doubt over its quantity;
- lack of information concerning the price and terms of payment (including currency to be paid);
- prospects of delivery (including vendors ability to make delivery according to contract).

The reason why the Holy prophet prohibited gharar in any business contract is obviously to ensure that one party does not have unfair advantage over the other. There are numerous verses in the Qur'an and examples form the sunnah of the Holy Prophet to support the fact that Islam seeks to ensure justice and fair play

in all business dealings. This is why the elements of uncertainty has to be avoided as far as practicable in every business transaction.

13. **Is there any element of Gharar in Insurance Contract ?**

The Quran Prohibits dealing with an intention to deceive by one of the parties in a contract. There are also clear prohibitory commandments of the Prophet with regard to fraud and deceit in business transaction. It is reported by Abu Hurayrah that the Prophet (P.B.U.H) passed by a man who was selling grain. He asked, " How are you selling it" ? The man then informed him. The Prophet then put his hand in the heap of grain and found it was wet inside. Then he said, "He who deceives other people is not of us ". The Prophet is also reported to have said, "It

is not permissible to sell an article without making everything(about it) clear, nor it is permissible for any one who knows (about its defects) to refrain from mentioning them". It is, therefore, evident that the duty of disclosure in Islam is applicable to all commercial contracts and not only to insurance contract. The conventional insurance contracts are contracts of " utmost good faith" which requires complete disclosure of all material facts. Therefore, contemporary Muslim thinkers are of opinion that Gharar Fahish (excessive) is not present in the insurance contract. However, Gharar Yasir (minor) is present in insurance contract, because the insurer and or insured do not know precisely about their respective rights and obligations till the occurrence of insured event. Furthermore, the importance of insurance and its indispensability in the modern life, brings it near to Darura (necessity) and, therefore, Mubah (permissible) provided every possible detail affecting both the parties (insurer and insured) is stated and there is absence of any ambiguity. Necessity can make forbidden things harmless. Insurance in its real sense, refers to community pooling to alleviate the burden of individual. Muslims do not find anything wrong if a member in the society is collectively assisted . An insurance contract, be it general or life simply means that both the insurer and the insured in a contract of insurance mutually agree to work for compensation or provide security against an unexpected peril. Such a concept is of course in line with the Islamic teachings. Islam encourage the ummah (community) to strive hard themselves to overcome difficulties in life. The Prophet (P.B.U.H) said to this effect, "Narrated by Abu Huraira, the Prophet (P.B.U.H) said: Whosoever removes a worldly grief from a Mumin (the believer in one God) Allah will take away from him are of the grief's of the hereafter. Whosoever alleviates a needy person, Allah will alleviate from his in both the world and hereafter" (Shahi Muslim). A contract of insurance does not appear to have elements of Gharar. This is because the subject matter of insurance is definite and certain. In the contract of insurance the principle of "utmost good faith" is applied, whereby the insurers are supposed to state in clear terms :

(a) under what circumstances the insured will get the compensation which has been promised

(b) how much the insured can get and what are the measurers of indemnity (principle of indemnity is applied)

(c) When and how the compensation will be paid (as per terms the policy and application of the principle of proximate cause)

Therefore, the allegation that an insurance contract involves the elements of Gharar, thus making it invalid appears to be groundless. However, it is evident

that conventional insurance contract is not transparent as it ought to be under the Islamic Shariah Principle.

14. **What are the Islamic Laws Relating to Mirath (inheritance) ?**

The Prophet (P.B.U.H) is reported to have said, "Learn the laws of inheritance, and teach them to the people, for they are one half of useful knowledge." The Islamic Laws of inheritance has been admired by modern writers because of its logical and technical excellencies of the system. The Islamic law of inheritance is based on the rules relating there to as laid down in the Quran or in the Sunnah. This is also based on the customs and usages prevailing amongst the Arabs in so far as they have not been altered or abrogated by the Quranic injunctions or traditions.

The principles of Islamic law are primarily based on the Quran. The Quran sometimes lays down general rules of inheritance, observance of which much depends upon interpretation. However, there are some specific and clear injunctions in the Quran. Those have to be followed literally without any question. For example, the Quran lays down the following rule:-

"**And into them (your wives) blongeth one fourth(1/4) part of what which leaves; if you have no issues: But if you have issue, then they shall have on one eighth (1/8) part of what ye leave**" (The Quran 4:11). This verse of the Quran is clear enough to need any explanation. However, inspite of the above provision, if husband feels that his children would not support their mother, or her share in inheritance is small, he may very well make a gift to her as per Islamic Law. In the Islamic law of inheritance there is no distinction between movable and immovable property and between ancestral and self acquired property. The right of an heir apparent or presumptive comes into existence for the first time on the death of the ancestor. He is not entitled until then to any interest in the property to which he would succeed as an heir if he survived the ancestor. Thus a son has no right in father's property during father's life time. Only father's death give birth to right as heir.

There are three classes of heirs, namely :

a) Sharers,

b) Residuaries

c) Distant kindred.

Sharers are those who are entitled to a prescribed share of the inheritance. Residuaries are those who take no prescribed share, but succeed to the "residue" after the claims of the sharers are satisfied. Distant kindered are all those relations by blood who are neither Sharers nor Residuaries. The first step in the distribution of the estate of a deceased Muslim, after payment of his funeral expenses, debts and legacies, is to allot respective shares to the Quranic heirs. If any residue is left, it is to be divided among Agnetic heirs (Residuaries). If there is neither Sharers or Residuaries, the estate will be distributed among distant kindred (Uterine Heirs). The distant kindered are not entitled to succeed so long as there is any Quranic Heirs (Sharers) and Agnetic Heirs (Residuaries) If there are no Sharers, the Residuaries will succeed to the whole inheritance. If there be neither Sharers nor Residuearies, the inheritance will be divided among such of the distant kindered as are entitled to succeed thereto. The distant kindered are not entitled to succeed so long as there is any heir belonging to the class of sharers or residuaries. But there is one case in which the distant kindered will inherit

with a Sharer, and that is where the Sharer is the wife or husband of the deceased. Thus if a Muslim dies leaving a wife and distant kindered, the wife as Sharer will take her share which is one forth and the remaining three fourths will go to the distant kindered. An if a Muslim woman dies leaving a husband and distant kindered, the husband as sharer will take his half share and the other half will go to the distant kindered. One of the rules of succession is that the nearer relation excludes the more remote. Thus if the surviving relations be a father and father's father the father alone will succeed to the whole inheritance, to the exclusion of grandfather and if the surviving relations be a son and a son's son the son alone will inherit the estate. The Islamic law of inheritance comprises the most refined and elaborate system of rules for the devolution of property. The logical strength of the system is admired by most of the jurists and they find it difficult to conceive any system containing rule more strictly just and equitable. It has been admired for its completeness as well as the success with which it has achieved the ambitious aim of providing not merely for the selection of a single individual or homogenous group of individuals, on whom the estate of the deceased should devolve by universal succession but for adjusting the competitive claims of the nearest relations.

15. **What are the Islamic Principles of Wasiyah(Will) ?**

Wasiyah means an endowment with the property of anything after death. It is an assignment of property to take effect after ones death. Wasiyah is the legal declaration of the intentions of a Muslim with respect to his property. A Muslim who is of sound mind and is major can make Wasiyah either verbally or in writing. Wasiyah or Wills are lawful in the Quran and the Sunnah. However, a Muslim can not by Will dispose of more than a third of the surplus of his estate after payment of funeral expenses and debts. Moreover, bequests in excess of the legal third can not take effect, unless the heirs consent thereto after the death of the testator. The limit of one third is not laid down in the Quran but deserves sanction from a tradition of the Prophet (P.B.U.H). It is said that the Prophet paid visit to Abu Bakar (a companion of the Prophet) while the latter was ill. Abu Bakar had no heirs except a daughter and he asked the Prophet whether he could dispose of the whole of his property by Will to which the Prophet replied saying that he could not dispose of the whole, nor even two thirds, nor one half, but only one third. A Muslim is precluded from making any bequest whatever to one who is entitled to a share in his estate as an heir unless the other heirs consent thereto. This rule is intended to prevent him form altering in any way the division of his estate between different heirs as prescribed under the law of inheritance (Mirath). It appears that the power of a Muslim to dispose of his property by Will is limited in two ways i.e.

a) as regards the person to whom the property may be bequeathed one, b) as regards the extent to which the property may be bequeathed.

The only case in which a testamentary disposition is binding upon the heirs is where the bequest does not exceed the legal third and it is made to a person who is not an heir. However, a bequest in excess of the legal third may be validated by the consent of the heirs. Similarly, a bequest to an heir may be rendered valid by the consent of the other heirs. If the testator has no heirs, he may bequeath the whole of his property to a stranger. If and when a legacy is given to an heir and a legacy also to a non-heir, the legacy to the heir is invalid unless assented to by the other heirs, but the legacy to the non-heir is valid to

the extent of one-third of the property. A bequest, though it be for pious purposes, can only be made to the extent of bequeathal third. If bequests are for religious or pious purposes but exceeds the legal limit of one-third then the priority would be determined in order of importance as per Islamic law.

16. **Is there any restriction regarding Gift (Hiba) ?**

Although Islamic Law allows testamentary disposition only within the limit of one third, a gift (Hiba) may be made without any restriction. It allows a Muslim to give away the whole of his property during his lifetime by way of Hiba or gift. Hiba, in Islamic law is the immediate and unqualified transfer of the corpus of the property without any return. Hiba is an immediate transfer of property by one person to another without any exchange and accepted by or on behalf of the donees. Juristically it is treated as consisting of proposal or offer on the part of the doner to give a thing and of acceptance of it by the donee. Until acceptance and delivery, the gift has no operation. The donee must accept the gift. This acceptance may be express or implied. When the donor makes a declaration of gift (real intention of making the gift) and the donee accepts, then the possession of the thing gifted should also be given to the donee. Such delivery of possession may be actual or constructive. The delivery of possession does not mean that the donor must have physical possession of the property and must hand over that possession to the donee. It is enough if he has got the legal possession. Where the subject matter of the gift is already in the possession of the donee, the gift is complete by declaration and acceptance, without formal delivery of possession. Every Muslim male or female who is major and sound may make a gift, provided he or she is not subject to any force or fraud. However, a gift made during death bed illness (marz-ul-maut) can not take effect beyond one-third estate of the donor (after paying funeral expenses and debts) unless the heirs give their consent, after the donors death. No such gift can take effect, if made in favour of an heir, unless the other heirs give their consent, after the donors death. A gift in death-illness takes place only when the donor dies. Such a gift is subject to all the conditions necessary for the validity of a simple gift, including delivery of possession by the donor to the donee. All forms of property over which control may be exercised are subjects of gifts. Therefore, an insurance policy is a fit subject of gift. Not withstanding the fact that the money is not existing and is to be realized in future, a policy holder may assign insurance policy by a valid endorsement. The basic concept of gift in Islam is that the donor should transfer the whole bundle of rights (ownership which he has) to the donee. Hiba in its literal sense signifies the donation of a thing from which the donee may derive a benefit. Therefore, an insurance policy may be assigned and the mere fact that the money will be realized in future is not enough to make it invalid. A gift may be made through the medium of a trust. In that case gift must be accepted by the trustee and possession should also be delivered to the trustee. However, when the subject of gift is not capable of physical possession (incorporeal rights), the gift may be completed by any act on the part of the donor showing a clear intention to divest himself of ownership in the property. Therefore assignment of an insurance policy in favour of the survivor or survivors shall be valid.

Chapter (III)

Insurance and the Shariah Law

1. Does conventional Insurance conform to Rules of Shariah?
2. Why conventional insurance is considered not in line with Shariah ?
3. Whether Conventional Insurance is fully unacceptable ?
4. Is Life Insurance permissible in Shariah ?
5. What are the similarities between insurance and gambling ?
6. How Insurance is different from Gambling ?
7. How Insurance is consistent with the Shariah Law ?
8. What are the Shariah Justifications for the Validity of Insurance ?
9. Does insurance deviate from the principles of Tawakkul and Takdir ?
10. How co-operative insurance is permissible in Islam ?
11. Is nomination of life insurance policy contrary to Islamic law ?

1. Does conventional Insurance conform to Rules of Shari'ah ?

Muslim Jurists had conducted a thorough and comprehensive study on the operation of the conventional insurance. Arising from these studies, the generally accepted view of the Muslim jurists is that the operation of the conventional insurance not in its present form conform to the rules and requirements of the Shariah. Therefore, after deep and thorough studies carried out jointly by the Muslim jurisprudents and economists, the principles of Islamic Insurance has been formulated as an alternative form of cover, which strictly conforms to the tenets of Islam. Islamic Insurance is based on the Islamic concept of "Al-Takaful" which means "Joint Guarantee". Under modern insurance terms this can also be termed as the concept of Mutuality.

2. Why conventional insurance is considered not in line with Shariah ?

The practice of insurance presently follow the western style of management and therefore, not in line with the teachings of Islam in a number of ways. For example it is alleged that :

1. Insurance contracts may contain maisir as it promises to pay more than the premium paid.
2. Insurance companies invest the premiums which they have collected, in interest bearing investment;
3. The conventional method of insurance is akin to gambling as one can lose the premium to insurance companies;
4. The western method of insurance may contain the element of gharar as the contract is not transparent.

5. Insurance companies can earn profits or loss as a result of death or accident or risk to people.

3. **Whether Conventional Insurance is fully unacceptable ?**

What is unacceptable to Muslims is the conventional insurance as being practised and not the idea of insurance. This is because any transaction (including insurance) must be in conformity with the Divine Rules and Regulations. For example, both the Quran and the Sunnah prohibit interest(Riba). Generally the money collected through premium is invested in the interest bearing deposits and or dealings which are not being transacted in conformity with Islamic rules and regulations. Therefore, it is necessary that an insurance contract should be operated based on the principle of Mudarabah and other financing techniques such as Musharaka, Ijarah, Salam, Istisna etc. Furthermore, the objective of an insurance contract should not be for a material gain nor to override the power and determination of Allah, but to achieve the pleasure of Allah. This has to be done through mutual help and cooperation with the object of providing assistance against unexpected future loss. This is why most Muslim jurists think that cooperative insurance system can be a basis of Islamic insurance system. The basic purpose of having an insurance cover should be to rescue helpless people from unexpected future loss. The Islamic Insurance schemes should be based on brotherhood, solidarity and mutual assistance, which provides for mutual financial assistance and aid, when it is needed. The objective of insurance contract should be the alleviation of hardship to ensure a comfortable life. The Quran says,

"Allah intends you to enjoy with an easy life. He does not wish you to face hardship," (The Quran at 2: 185).

Insurance is generally rejected by Muslim juristis, because of the presence of Gharar. But we find that the element of uncertainty is of minor nature at the individual level, while at the collective level, they are scientifically determined by laws of large number, actuarial science and the theory of probability. Therefore, it is not justifiable to prohibit insurance due to Gharar at the individual level. Furthermore, the insurance contract as we see today was not exactly practised during the time of the Prophet. But with the passage of time, we observe that there is an urgent need to find a way of providing material security for those who are suffering in the society due to unexpected loss. Insurance is necessary in the public interest so that the victims can be rescued from unexpected and undesired risks. This is justified in Islam by the Doctrine of Masaleh al-Marsalah. (Doctrine of Necessity). Insurance , though permissible as a necessity, should be operated with the principles laid down in the Quran and the Sunnah. It is alleged that insurance is Maisir(gambling) because the policyholders are paying premium on the condition that insurer will pay him on the happening of specific events. We have observed that insurance is a contract of indemnity which is completely different and opposite to a gambling and wagering contract. In a gambling contract on the happening of the specified event one of the parties must win or lose. In the case of insurance the specified event may or may not occur during the policy period. Moreover, the insured holds a specific financial interest (insurable) in the subject matter of insurance. The insured is supposed to get indemnity only if he suffers loss and indemnity is limited to actual loss or damage. While the act of gambling creates a new risk, insurance contract provides a mechanism for managing inherent and predictable risks to make losses bearable to the individuals susceptible to such risks. Insurance is a systematic

pooling of individual resources to cover collectively the expected inherent risks of loss that each and every person faces. The purpose of insurance is to protect, not to enhance the financial position of the insured. Therefore, it is not gambling. Obviously, if insurance is operated as contract of guarantee, rather than an exchange of money, then it is absolved of contractual Riba(interest) and Maisir (Gambling). The Quran ordains compensation including monetary benefits to the victims family for killing someone by mistake. Therefore, in principle there is no harm in obtaining monetary helps against the death of a family member which seemingly justifies conduct of life insurance. Despite all these positive factors, insurance remains a controversial matter within the Muslim communities.

4. **Is Life Insurance permissible in Shariah ?**

There are conflicting views amongst the Muslim Jurists about life insurance. While one school of thought had objected to the modern form of life insurance contract, another school of thought considered it permissible in Islam under certain conditions.

Arguments against life insurance :

(a) There is no justification for a person, giving a part only of a sum, to be entitled to get the whole in case he dies. This is nothing but gambling.

(b) The system of life insurance is based on Riba.

(c) Life insurance pays for something which can not be valued or indemnified.

(d) It does not befit a Muslim that he should have faith in life insurance because it may provide maintenance to his heirs. He should have complete reliance on Allah.

(e) The policy amount is paid to the nominees. This is contrary to the law of inheritance in Islam.

Arguments for Life Insurance:

(a) Insurance, in all its kinds, is an example of co-operation of a group of people and helpful to society. Life insurance is beneficial to individual and there is no harm in getting assistance from the group.

(b) There is precedence in Islamic history of compensating death by way of paying “blood money” and, therefore, value of human life can be measured for compensation purpose.

(c) Under the life insurance scheme people deposit an amount with an insurance company with the intention of saving a desired amount. But under the scheme even on premature death of the savers, the shortfall of the desired amount of savings be compensated from a common fund. Therefore, it is in no way a reliance on insurance instead of Allah.

(d) The system of nomination of life insurance can be suitably modified and amended to make it non-conflicting, with the Islamic laws of inheritance.

Considering the conflicting views, it has been felt since long that experts and thinkers from amongst the Ulema and the economists need to study the problems deeply and give their unanimous opinion otherwise people will remain divided and undecided.

Although no such unanimous opinion has so far been derived, an alternate to life insurance has been suggested by many Muslim thinkers. According to them,

the amount paid towards insurance policy be invested on the principle of Mudaraba in commercial pursuits and the insurance organizations should function on mutual basis. Family Takaful or Islamic Life Insurance is now being practised in many of the Muslim Countries.

5. **What are the similarities between insurance and gambling ?**

Many Muslims think that insurance is similar to gambling. According to them similarities of Insurance and Gambling are as follows :

- The gambler as well as the insured could receive huge amount of money, without equivalent input from their side;
- Most insureds, like most ever-losing gamblers, go on paying premium without ever getting any amount in return;
- Just like the bookie, the Insurer loses if there are too many claimants. On the other hand if the premium collected in any given year exceeds the claims plus other operating expenses, insurers could make huge profits;
- Both the bookie and the insurer calculate the possibilities of a certain event occurring and will indicate a certain rate at which they will be prepared to assume the risk. The bookie will quote the 'odds' while the insurer will quote the premium.

What needs to be examined is whether the similarity is merely superficial or that gambling is inherent to the insurance business. As we have seen before, one ingredient of gambling is the existence of the element of uncertainty (gharar). For example when a gambler buys a lottery, he is uncertain whether he would get anything or not. In some cases, if he does get something, he does not know how much it will be exactly. In most cases however, the gambler gets nothing at all.

6. **How Insurance is different from Gambling ?**

Insurance is not gambling for many reasons which can be stated as follows:-

A contract of insurance is bound by the general principles of the law of contract but a gambling contract is not enforceable at law. The purpose of having an insurance policy is to indemnify oneself against unforeseen loss and is mainly based on the principle of mutual co-operation. The fundamental principles of an insurance contract are consideration, insurable interest, utmost good faith and so on. These fundamentals and essentials of an insurance contract make it different from gambling. The financial motivation of gambling is provided by the gain in the event of winning, while in the case of insurance it consists in the desire to have protection against loss. On the other hand, the amount received by the insured is not a gain. It is a compensation or financial aid after loss. The money that a gambler wins is a profit. But in insurance, there is no element of profit.

A pertinent question is that whether an insurer is guilty of wrongful devouring of the money of the insured. This may happen when the insured does not get back his premium if claim does not occur. Some scholars are of the opinion that insurance premium is in fact a price against a service. The insurer promises to provide security against possible loss of property. The contract of insurance is a contract of indemnity. Since there is no loss, there cannot be an indemnity. The premium, therefore, should be viewed as cost of services. It cannot be considered as wrongful devouring. It is totally different from the money earned from gambling. The owner of a casino house or the sponsors of horse race for betting

do not render any service to the gambler and or to the society. On the other hand insurers provide an essential service to individual as well as to the society at large. Furthermore, insurance is not a game of chance. The amount of money required to meet the likely future claims can be measured by applying the law of large numbers. It is possible to calculate the average number of motor accidents, fire losses etc. per year. Actuarial science is verily applied to accurately measure the long-term liability of life insurers. Mortality table, morbidity rates are prepared on the basis of past statistics. This means, although the loss is uncertain or unknown to an individual, but the insurer can predict it in order to calculate premium based an probable losses against risks they underwrite. This is the reason why an insurance contract deals with pure risks and not the speculative risks. Insurers can predict and calculate the amount of losses as they take into account of the group as a whole faced with particular and pure risks. Speculative risks are not accurately predictable and measurable and, therefore, not insurable. There are several other differences between gambling and insurance contract. For example, applicability of insurable interest is a fundamental requirement for an insurance contract. This means without having any insurable interest on the subject matter of insurance, no one can effect the contract. Generally, the insured must have insurable interest at the time of loss of the subject matter of gambling. This makes the contract of insurance legally binding. But in case of a gambling contract, the gambler is not supposed to have any interest on the subject matter of insurance. The gambler is not interested to protect the property. His is not concerned about the security aspects of the subject matter and, therefore, not interested to improve the risk. The gambler hopes that the event he bets against will occur and he will make profit without any effort on the happening of that event. On the other hand when the insured buys an insurance policy, he does not want that there should be an accident on his motor car or a fire should cause loss to his property. Insurance cover is purchased to protect the property. This is done as a precautionary and security measure. The gambler is motivated by the hope of financial gain, but the insured is motivated by the desire of financial protection against the possibility of a loss. Insurance cover is necessary to protect the property from the existing pure and particular risks. This is a means of mitigating loss, but a gambler always creates the risk. He willfully seeks at risk which was not there. These risks can be avoided. On the other hand the risk of fire, accident, for example are always there, whether or not an insurance contract is made to mitigate those likely losses. Last but not the least, gambling is not useful and desirable to the society, whereas insurance provides a valuable service to the society, therefore, is desirable. From the point of view of desirability and usefulness, one can conclude that insurance contract is not a gambling contract. Islam does not permit gambling because it is not useful to the society.

7. How Insurance is consistent with the Shariah Law ?

According to the teachings of Islam, all that happens in this world is by the will of Allah, and although Muslims are taught to accept any misfortune that befalls them as the will of Allah, they are also exhorted to take positive steps to minimize such unfortunate events. The usual way that people attempt to reduce the risk of loss due to accident or ill luck-insurance contract however, is undermined by the uncertainty with regards to its conformity to the Shariah, and hence its acceptability to suit Muslims needs.

Muslim scholars differ in their views on the permissibility (Halal) or prohibition (Haram) of insurance . Some accept insurance in its current form as part and parcel of the necessary development of modern Islamic concepts. Others, thinks that insurance should be prohibited due to its inherent aleatory elements- a wagering contract of which the consequences are unknown. Such a contract would posses the prohibited elements of uncertainty of outcome(Gharar) and gambling(Maisir), and is frowned upon by the Shariah laws. According to Ibn Taymah, "each contract whose consequences are held in ignorance, includes a form of aleatory". Following this view, even the presence of insurable interest would not save the commercial insurance contract from the Shariah laws, as the outcome of an insurance contact is, by its very nature, unknown. The opposite view is that since there is no injunction (Nass) against conventional insurance, it should be allowed (Mubah). This argument is based on the established legal maxim that the original legal position on any matter is permissibility until there is evidence prohibiting it. According to this group, the universe is described as an adornment of Allah. The Quran says:

"*Who has forbidden the adornment of Allah which He has brought forth for His bondsmen, and the good things of His providing ?" [7.32]*

Muslims are allowed to use the resources of the universe, and all that is needed to facilitate this usage are thus permissible. The Quranic verse in this respect is:

"We have subjugated to you all that is in the heavens and the earth" [45:13]

A mere presumption is, thus, insufficient to declare something as unlawful. Muslim scholars have held that any injunction that overrules this principle of permissibility must be decisive in meaning and transmission (*Nassan qati'ul thubut wad-dalalah).* Furthermore, insurance is argued as valid contract since it brings Maslahah (benefit) to the Insured:

"........Help Ye one another in righteousness and piety,

but help Ye not one another in sin and rancour...." [5.2]

In short, the role of insurance in creating a fund to help alleviate the losses of the unfortunate is, in their view, consistent with the Shariah law as long as it is intended for a good cause.

8. **What are the Shariah Justifications for the Validity of Insurance ?**

An Insurance transaction is quite similar to the principle of Al-Wadiya (deposit) whereby two parties engage themselves in an agreement in which one of them deposits money to the other as a trust or 'Amanah' for the purpose of safe keeping. Likewise, such methods of dealing also exists in a contract of insurance as the insured deposits money to the insurer for future safety. The governing principles of al-Wadia' had been developed from the Holy Quran. Allah (SWT) says to the effect:

..........."Verily Allah (SWT) commands you to render back your trust to those to whom they are due".

The practice of insurance policy is also actually based on Inter Alia the doctrine of public interest or 'Masaliah-al-Mursalah' for the purpose of eliminating hardship from one's life, while taking an initiative to look after the welfare of the poor who may have suffered resulting from an occurrence of loss or damage. It is thus, justified in the holy Quran, that Allah (SWT) has always wishes good and

convenient life for His creatures without having to face any difficulty. Allah (SWT) says to the effect: .... "Allah (SWT) intends easy life for you while He does not want to put you to difficulties ...."

An insurance policy does not signify an opportunity for the insured to hope for a change for a material gain. In fact, it is a transaction whereby the insured takes an initiative, to the best of one's ability, to be compensated or in the event of unexpected loss, damage or peril. Such compensation and indemnity has been mutually agreed by both the insurer and the insured. And this further signifies the element of mutual co-operation between both parties to the contract of insurance. The principle of mutual is justified in the Shariah. Allah (SWT) says to the effect: **"Maintain a mutual co-operation among yourselves in righteousness and piety"**

An insurance policy involves an element of donation or Sadaqah. For instance, the insured in a general policy pays regular premiums for the purpose of compensation in case of an unexpected loss or damage occurring to a particular subject matter. However, if there is no occurrence of loss to that subject matter, the premiums will be non-refundable. Meanwhile in a life insurance policy, the assured pays amount of donation to the charitable fund for the beneficiarys of the assured as an addition to the paid premiums and share of profits. The Holy Prophet (SAW) also used to accept donation. Thus, a life insurance contract which involves the elements of donation could be held lawful.

The nature of life insurance policy is similar to that of a retirement pension scheme Contemporary Islamic scholars unanimously agreed on the lawfulness and validity of a retirement pension scheme. The scholars of Islamic Jurisprudence had approved the idea of pension scheme for the reason of ensuring material security for the subscriber himself as well as his family in cases of difficulties or death. Some scholars went on to defend the validity of life insurance in reliance of the approval all Islamic scholars to the pension scheme. They posed a question why family security should be rendered lawful in a pension scheme, and unlawful in a life insurance policy ? When the methods of operations are practically the same ? It was also inferred that the reason why all Ulama accepted the idea of retirement pension is that it was widely accepted during the time of Omar (R). Hence, it is submitted that, life insurance policy is similar to that of pension scheme and hence should be held valid.

9. **Does Insurance deviate from the principles of Tawakkul and Takdir ?**

Tawakkul is the part and parcel of Tawhidi Iman. In all situations mumin must rely into Almighty Allah for his subsistence and security. But such a reliance does not in any way imply any inactiveness on the part of an individual. Once Hazrat Amar-ibn- umayyah Zamri (R) requested Rasul-e- Karim (SM), "Do I rely on Allah after allowing the camel, on which I came to you, untethered or keeping it tethered" ? In reply the prophet said, "No, first tether the camel and at the same time rely on Allah." Bukhari Sharif reveals that the prophet Mohammad (SM) himself used to carry with him necessary food and drink at the time of his meditation in the cave of Hera. These amply justify that these are well within the domain of Tawakkul.

In Sura Ibrahim (verse 34) and Sura Al-Mulk (verse 15) Allah the Almighty enjoins upon his creation to rely unto Him but at the same time to make full use of their mind and labour for extracting the 'niamats' that have been scattered

around. In view of this it appears that there does not seem to be any material difference between Tawakkul and concept of insruance which aims at extracting ‘niamats’ for security and peaceful co-existence. Coming to the issue of T akdir it may be noted that Allah has determined the destiny (Takdir) of each individual before his birth. But he has also allowed freedom of thought and action to the individual endowing him with a free conscience. Each individual has the power to distinguish right from wrong and good from evil. Allah has sent us on this earth with the dual objective of living a decent living here and acquiring virtues for salvation hereafter. For decent living here, we are free to adopt any pursuit (Hekmat) which our conscience deems right and good and which does not impede the smooth, clean and peaceful functioning of the social organism. Insurance is such a ‘Hekmat’ which aims at ensuring a better living for the creation. Hence, in principle, insurance does not deviate from this spirit as laid down by the concept of ‘Takdir’.

10. **How co-operative Insurance is permissible in Islam ?**

Co-operative insurance is permissible in Islam because it is a sort of co-operation for good things and due to this the Islamic Banks institutions and or individuals may establish Cooperative Insurance Company to transact Insurance business but it should be stated clearly in the contract of Insurance that it is a co-operative contract and every insured pays his subscription in order to assist those who need assistance. This is the general opinion of the Shariah experts about legality of co-operative insurance. The Shariah scholars agree that the proposed co-operation may take the features of an co-operative insurance company since it is not against the Islamic Laws. However, there should be certain additional conditions to be included to the insurance contract in order to distinguish between the co-operative insurance contract and the commercial insurance contract. These conditions are :

a) Partnership condition.

b) Investment condition.

The partnership condition will allow the policyholders to have the right in the surplus profits and also may be asked to contribute additional premiums if the fund was not sufficient to meet the accrued losses. The investment should be in the sources which are not forbidden by the Islamic Laws and should follow Islamic Law in such investments.The experts agree to the addition of these conditions to the commercial insurance policy. The policy conditions should also be revised. If any condition is formed against the Islamic law should be deleted. For example, nomination in a life policy should be as per Islamic Law of inheritance.

11. **Is nomination of life insurance policy contrary to Islamic law ?**

It is generally alleged that a life insurance policy is contrary to the principles of Mirath and Wasiyah. This is because in a life insurance policy the nominee is an absolute beneficiary over the policy after the demise of the insured. From a ruling of the High Court in Pakistan it is observed that, nominee in a life insurance policy has an absolute right over the amount of the benefits (Kasim V Hanifa) But under Islamic law, a nominee should act as a trustee and is under an obligation to receive the benefits over the policy on behalf of the heirs of the deceased and distribute the benefits among the heirs of the deceased in accordance with the principles of Mirath and Wasiyah (Islamic law of Inheritance and Will). The nominee in a life insurance contract is not an absolute

beneficiary but a mere trustee and the nominee may only receive a portion of the benefits if he or she is one of the legal heirs of the deceased policy holders. The National Council of Muslim Religious Affairs in Malaysia issued a Fatwa (religious ruling) to the effect in 1974, which states that the nominee of the life insurance policy is a mere trustee, who is supposed to receive the benefit of the policy and distribute it among the heirs of the assured according to the Islamic law of Mirath and Wasiyah. In Pakistan the decision of the Karachi, High Court(Kasim Vs Hanifa) was overruled by the supreme Court of Pakistan in Amatol Habi vs Musarrat Parveen (1974 PLD 185 SC). In this case it was decided that the nomination in a policy does not constitute a gift nor a bequest, and, therefore, nomination shall not deprive the legal heir of the nominator who may be entitled there to benefits under the law of the Mirath as applicable. It is, therefore, clear that there is nothing wrong for the policyholder to nominate some one for the security and fair distribution of the benefits over the policy. The nomination is not a gift(Hiba) but a mere trust in which the nominee is under an obligation to receive the benefits from the policy and distribute them among the beneficiary of the policyholder. The nominee is also entitled only to the portion of the benefits according to the principles of Mirath. But if the policyholder makes a Will (Wasiyah) for the nominee, he may get only up to one-third of the benefits and if the nominee is among the heirs of the policy holder, and policy holder makes a Will for him, he may be entitled only up to one-third of the benefits, subject to the consent of the other heirs of the policy holder.

Chapter (IV)

Principles of Islamic Financial System.

1. What is the basic principle of Islamic financial system ?
2. What is the characteristic of Islamic Financing ?
3. What are the differences between Conventional Financing and Islamic Financing ?
4. What are the Islamic Financing Principles ?
5. Which commercial Transactions are allowed in Islam ?
6. What is Riba ?
7. Is Riba fully prohibited ?
8. What is the rationality of prohibiting Riba ?
9. What is the prospect of Islamic Financial System ?
10. What are the recent initiatives towards sound Islamic Financial System ?

1. What is the basic principle of Islamic Financial system?

So far as commercial financing is concerned the Islamic Shariah Principle is that the person extending money to another person must decide whether he wishes to help the other party or he wants to share in his profits. If he wants to help the borrower, he must resist from any claim to any additional amount other than the principal amount. His principal amount will be secured and guaranteed but no return over and above the principal amount is legitimate. But if he is advancing money to share the profits earned by the other party, he can claim a stimulated proportion of profit earned by him. In certain cases he must share his loss also if he suffers a loss. If financing is made for a commercial purpose it can be based on the concept of profit and loss sharing , known as the “Musharakah” financing. The other alternative financial principle is financing on the basis of “Mudarabah”. *One of the most important characteristics of Islamic Financing is that it is an assets backed financing. Islam does not recognize money as a subject matter of trade except in special cases. Money has no intrinsic utility. It is only a media of exchange, therefore, there is no room for making profit through the exchange of money only. Financing in Islam is always based on assets and inventories.*

2. What is the important characteristics of Islamic Financing ?

The conventional mode of financing deals with money. Islam on the other hand does not recognize money as a subject matter of trade as money has no intrinsic utility. Money is

only a medium of exchange. One can earn profit by dealing with money when some thing having intrinsic utility is procured. The profit earned from dealing in money is interest. Interest is strictly prohibited in Islam. Financing in Islam has to be always an asset backed financing. Financing in Islam always based on real assets and inventories. All the modes of financing such as, Musharakah, Mudarabah, and Murabaha are fully backed by assets and financing through these instruments is different from interest base financing.

3. **What are the differences between conventional financing and Islamic financing?**

In the conventional financing system money may be advanced for any profitable purpose but under Islamic financial system financing can not be made for any purpose which is prohibited in Shariah.In conventional financing the financier gives money to his clients as a interest bearing loan but under Islamic financial system interest is prohibited and therefore, it has to be always backed by assets. Under Islamic financial system, the profit earned by the financier is the reward of the risk he has taken . In conventional financing the providers of the fund do not assume any risk as it is interest based.

4. **What are the Islamic Financing Principles ?**

In order to conform with Islamic rules and norms, four religious features, must be followed in investment behaviour. These are:

a) the absence of interest-based (riba)financial transactions;

b) the introduction of an Islamic tax, zakat;

c) the discouragement of the production of goods and services which contradict the value pattern of Islam(haram);

d) the avoidance of economic activities involving speculation (gharar).

5. **Which Commercial transaction are allowed in Islam ?**

Many verses in the Qur’an encourage trade and commerce, and the attitude of Islam is that there should be no impediment to honest and legitimate trade and business, so that people earn a living, support their families and give charity to less fortunate. Just as Islam regulates and influences all other spheres of life, so it also governs the conduct of business and commerce. Muslims ought to conduct their business activities in accordance with the requirements of their religion to be fair, honest and just towards others. A special obligation exists upon vendors as there is no doctrine of caveat emptor. Monopolies and price-fixing are prohibited. The basic principles of the law are laid down in the four root transaction of (1) sales (bay), transfer of the ownership or corpus of property for a consideration; (2) hire (ijara), transfer of the usufruct (right to use) of property for a consideration; (3) gift (hiba), gratuitous transfer of the corpus of property, and (4) loan (ariyah), gratuitous transfer of the usufruct of property. These basic principles are then applied to the various specific transactions of, for example, pledge, deposit, guarantee, agency, assignment, land tenancy, waqf foundations (religious or charitable bodies), and partnership.

6. **What is Riba ?**

The Arabic word ‘riba’ literally means ‘increase in’ or ‘addition to’ anything. Islam prohibits the lending of money for profit because it is often ruinous to the borrower and at the same time makes the lender greedy and selfish. Islam seeks to protect the weak from exploitation and to encourage partnership between investors and entrepreneurs on a more quitable basis such as mudharabah. The law prohibiting riba was introduced gradually. One of the commandments forbidding Muslims to earn interest form loan for example, was made through the following Qur’anic verse: Although Islam prohibits riba it does not prohibit trade. The proof of this is that the Holy Prophet himself indulged in business. However some people were mixing trade with interest and insisting that there is no difference between the two. The Qur’an however states: “they say ‘trade is just like interest’ whereas Allah has permitted trade and forbidden interest.”

Scholars generally agree that it is riba if interest is charged for a loan given, whether it is on the principal (riba qard) or as penalty for late payment (riba jahilliyah). In addition, the Holy Prophet on the authority of a sunnah also considers it riba to exchange the following goods, known as ribawi items, if there is any difference in terms of quantity, quality and/or time :

- gold for gold;
- silver for silver;
- wheat for wheat;
- barley for barley;
- dates for dates: and
- Salt for salt.

Some Scholars have by the process of analogy extended the above ribai items to include money and all types of foods. This is because gold and silver were used as a medium of exchange just like money is being used today.

7. **Is Riba fully prohibited ?**

The Arabic word ‘riba’ means “increase” in or addition to anything. It means predetermined return on the use of money. Islam prohibits riba, because it is often ruinous to the borrower and at the some time makes the lender greedy and selfish. Islam seeks to protect the weak from exploitation. The prohibition of ‘riba’ is accepted by all the Muslim jurists. It is an absolute prohibition which covers simple and compound interest, productive as well as non productive loans. Even in case of productive loans guaranteed return on capital is unjust and prohibitive.[9] Both the Quran and Sunnah prohibit ‘riba’. Those who disregard the prohibition of riba are in direct conflict with Allah and His Prophet Muhammad. Riba is completely prohibited under Islamic Law, because Shariah does not consider money as commodity as such that there should be a price for its use. Islam does not permit gain from financial activity unless the beneficiary is also subject to risk of potential loss; and that Islam regards the accumulation of wealth through interest is selfish compared with that of accumulated through hard work. It makes no difference whether return is fixed or variable percentage of the principal, an absolute amount to be paid in advance or maturity, or a gift or service to be received as a condition of the loan. There is no room for argument that riba refers to usury and not interest. Absolute prohibition of riba or

interest in the Quran and the Sunnah is a command to establish an economic system in which all forms of exploitation are eliminated. The prohibition of interest is a way to establish justice between the financier and entrepreneur. According to Islamic Fiqh, there are two kinds of Riba viz

a) Riba an Nasia (postponed with using) and

b) Riba al Fadl (the surplus).

The word Nasia means delay granted to the debtor. It is used in this sense because the creditor permits the delay in payment of the debt in consideration of something in excess over the principal. Riba-an Nasia is a loan agreement, whereby the borrower should pay a certain extra amount over and above the payment of principal amount against the specified deferment. This is strictly prohibited as it is considered unjustified enrichment and monetary advantage without a counter value. Riba –al-Fadl relates to the excess charged in sale transaction. Riba –al-Fadl applies when commodity exchange contracts provide payment of any extra quantity of the commodities. Rib-al Fadl is prohibited by the Prophet Muhammad (P.B.U.H) as a precautionary and preventive measure lest it should lead to Riba-an Nasia (Postponed with riba). The Quran has not left any ambiguity in respect to the concept and definition of Riba. It explicitly and categorically lays down that : " **O believers, fear God, and give up the riba that remains outstanding if you are believer**" (The Quran 2:278). It also says : "**Allah has permitted trade but forbidden Riba**" (the Quran 2: 275) Therefore, the legal position is that if a loan is given or taken for moral or humanitarian reasons, the principal amount should be protected and any excess on that is forbidden as immoral and exploitative. If loan or investment is made for economic reasons then the owner of capital has no right to demand a fixed rate of return. This is because one can not ask for any additional payment without sharing the risk of business. The Quran makes no distinction between loan given for consumption purpose or productive ventures.

As per Islamic law, interest free loans are meant for cooperative and charitable activities. So far as commercial financing is concerned, the Islamic Shariah has a different set up for the purpose. The principle is that the person extending money to another person must decide whether he wishes to help the opposite party or he wants to share in his profits. If he wants to help the borrower he must rescind from any claim to any additional amount. His principal will be secured and guaranteed, but no return over and above the principal amount is legitimate. But if he is advancing money to share the profits earned by the other party, he can claim a stipulated proportion of profit actually earned by him, and must share his loss also, if he suffers a loss. This means, if financing is meant for a commercial purpose, it can be based on the concept of profit and loss sharing.

8. What is the rationality of Prohibiting Riba ?

What is forbidden in Islam is the fixed and predetermined return against commercial financing. Variable return on the basis of actual productivity and profitability of a venture is perfectly legitimate. As such all modes of financing under Islamic Law have to be risk sharing and consequently profit-and- loss sharing. One of the most important characteristics of Islamic financing is that it is an asset backed financing. Islam does not recognise money as a subject matter of trade, except in some special cases. Money has no intrinsic utility, therefore, there is no room for making profit through the exchange of these units inters.

The profit earned through dealing in money is interest, hence, prohibited. Financing in Islam is based on illiquid assets which create real assets and inventories. Islam does not recognise capital and entrepreneur as two separate factors of production. Every person who contributes capital to a commercial enterprise assumes the risk of loss, therefore, is entitled to a proportionate share in the actual profit. In this manner capital has an intrinsic element of entrepreneurship, so far as the risk of the business is concerned. Therefore, and "Mudarabah" are the well known forms of profit & loss sharing instead of a fixed return as interest, it derives profit. Exclusion of interest from financial activities does not mean that the financier can not earn a profit. If financing is meant for a commercial purpose, it can be based on the concept of profit and loss sharing. "Musharakah and Mudarabah two forms of Islamic financing which have been designed since the very inception of the Islamic Commercial Law. The contemporary scholars have also suggested other forms of Islamic financing. In the past, there has been dispute about whether riba refers to interest or usury. But, there is now concensus amongst Muslim scholars that the term riba covers all forms of interest and not only excessive interest. Historically, interest and usury were always treated as one and the same thing. It was only in the post Christian, post Renaissance period of European history that the term interest was used as a substitute for usury to wriggle out of the religious and moral prohibition. All transactions, commercial or non-commercial, individual or corporate, private or public, which involve a predetermined rate of return on loan, in money or kind fall within the scope of riba and as such are forbidden. Advances, loans, and interest based financial instruments used by banking and financial institutions are not permissible under Islamic framework. Therefore, Muslims have evolved several alternate instruments of financing. Islam allows loan giving and loan taking under certain circumstances on ethical and philanthropic grounds. The concept of a debt based economy is alien to Islamic approach. Under on Islamic aegis, self financing, cooperative financing, indirect financing have a role to play on the basis of risk sharing and not on the basis of a predetermined fixed return. Financial capital can earn income only by bearing and sharing risk of losses. Therefore, all banks, insurance companies and financial institutions will seek and provide finances which will always have some element of risk bearing. According to Islamic principles, a financier must determine whether he is advancing a loan to assist the debtor on humanitarian grounds or he desires to share his profits. If he wants to assist the debtor, he should resist from claiming any excess on the principal of his loan. However, if he wants to have a share in the profits of his debtor it is necessary that he should also share him in his losses. This is called under Islamic terminology the principle of "Musharakah", which literally means sharing. Since Islam has prohibited any form of interest "Musharakah" can play a vital role in the Islamic financial system. One of the pillars of the Islamic economic and financial system is the very prohibition of riba. This prohibition can not be isolated nor can it be used as ammunition against the Islamic faith. Islam's prohibition of riba is only one of the many blessings it has brought to mankind. The prohibition of riba by Islam has brought about the eradication of one of the root causes of human conflict. Indeed this is in consonance with Islam's general aim of building a society in which peace, harmony, cooperation and collaboration are its cornerstones.

9. **What is the prospect of Islamic financial system ?**

The Islamic financial system is fundamentally based on the absolute prohibition of payment of any predetermined or guaranteed rate of return, therefore, prohibiting the concept of interest (usury). Debt slavery, had clearly not been fully abolished in the International financial system, with countries unable to pay their foreign debts at the mercy of rich countries. Obviously, if Islamic financial system is practised in international financial transactions leading this debt slavery of borrowing countries can not happen. The establishment of the Islamic Financial Services Board (IFSB), a result of two years of extensive work, would reinforce the potential for stability in the Islamic financial system and chart its future course as an integral part of the international financial system. It is hoped that IFSB could become the pre-eminent global authority for international Islamic financial services. The Establishment of the IFSB is a historic event for the Islamic Financial Service Industry. It marks a new era which would likely to witness a rapid growth in the near future. The Islamic financial Service Industry has no doubt proven to be one of the most desired industries. It is growing today at an estimated 10% to 15% a year. There are approximately 250 Islamic Financial Institutions that currently operate in approximately 75 countries. Given the rate at which the industry is growing no global operator can afford to ignore this market.

10. What are the recent initiatives Towards sound Islamic Financial System ?

In an endeavour to build a strong and sound Islamic Financial System the critical milestone was the establishment of the Islamic Development Bank in 1975. The second was the establishment of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in 1990. The establishment of the Islamic Financial Services Board marks another important milestone. The Islamic Financial Services Board (IFSB) was established with the signing of the Articles of Agreement of the IFSB on third November 2002 at Kuala Lampur by the founding members comprising Bahrain Monetary Agency, Bank Indonesia, Bank Markazi Jomhouri Islamic Iran, Central Bank of Kuwait, Bank Negara Malaysia. State Bank of Pakistan, Saudi Arabian Monetary Agency, Bank of Sudan and Islamic Development Bank. Islamic banking and insurance is ascending to greater prominence in the global financial system and has fast extended beyond the traditional predominantly Muslim economies to major industrial economies. This growing significance is a manifestation of the viability of Islamic financial intermediation channel that supports economic growth and development of nations. While it was initially developed to fulfil the needs of the Muslims; Islamic banking and Insurance have now gained universal acceptance. The appreciation of its promising potential has prompted interest amongst conventional financial institutions to venture into this fast expanding market. In essence, Islamic banking and insurance can expect to evolve into an increasingly important component of the global financial system of risk management instruments, cultivation of sound risk management practices and facilitate the implementation of robust risk control mechanisms in Islamic financial institutions through research, training and technical assistance. This would encompass the adoption of international best practices on risk management standards as well as the development of new risk management techniques in conformity with Shari'ah injunctions.

Chapter (V)

Concept & Methodology of Islamic Insurance (Takaful)

1. What is Takaful ?
2. What is the basis of Takaful ?
3. What is the Nature of the Takaful Contract ?
4. What is the basic concept of Takaful ?
5. Why Takaful has emerged ?
6. How Takaful suits in Islamic Economy ?
7. Why study of Islamic Insurance is important ?
8. What are the Distinctive Features of Takaful System ?
9. What are the Features of Islamic Insurance company ?
10. What are the modes of investment of a Takaful company ?
11. What is the objective of Islamic Life Insurance ?
12. How Family Takaful Companies Operate ?
13. What is the modus operandi of Islamic Life Insurance ?
14. What are the distinctive features of Family Takaful Scheme ?
15. What are the Arguments against and for life insurance ?
17. How Takaful is beneficial to the society ?
18. How the policy money may be distributed ?
19. How co-operative clause is incorporated in Takaful contract ?
20. What are the functions of shareholders in Takaful system ?
21. What is Shariah Supervisory Board ?
22. Why Shariah Supervisory Board is necessary ?

1. What is Takaful ?

Islamic Insurance (Takaful) is an alternative form of conventional insurance based on the concept of trusteeship and cooperation inspired by the beliefs of the followers of Islamic teaching. Muslim societies in different parts of the world are now practising Takaful scheme as their own way of sharing financial responsibilities to assists each other. They have invented an Islamic way of mutual assistance to deal with uncertainties of life. Takaful is a social scheme based on the principles of brotherhood, solidarity and mutual assistance. It

provides mutual financial aids and assistance to those who are members of the takaful scheme and voluntarily agree to contribute a certain amount of money for that purpose. It is a mutual agreement among the participants of the scheme. This has its origin from the concept of collective sharing of individual's loss. Takaful, is being practised now as an alternate of conventional insurance system and is bounded by Islamic principles, rules and the laws of Islam (Shariah).

2. **What is the basis of Takaful ?**

Takaful is an Arabic word stemming from the verb "kafal" which means to take care of ones needs. Under this scheme, the members or the participants in a group agree to jointly guarantee themselves against loss or damage caused by specified perils. The entire group would assist the incumbent person from the fund they have created to alleviate his loss and or to provide him with financial help. Takaful is a legally binding agreement between all the participants of the scheme to pay any of the members who suffer a loss as specified in the takaful certificate. Takaful scheme has been evolved from the teachings of Islam i.e. on the basis of the Quran and the Sunnah (Traditions of Prophet Muhammad). The Quran says :

"Help ye one another in righteousness and piety, but help ye not one another in sin and rancour." (The Quran 5:2)

The Prophet Muhammad said:

" The believers, in their affection, mercy and sympathy to each other, are like the body, if one of its organs suffer and complains, the entire body responds with insomnia and fever" (Muslim).

The fundamental basis of Takaful scheme is that its operations do not involve any element which is not approved by the Sariah. (Laws of Islam). Therefore, it is necessary that the Takaful operators should establish and maintain Takaful fund for the class or each of the Takaful schemes carried on by the operators. The assets comprised in the fund shall be applicable only to meet such part of the operators liabilities and expenses as is properly so attributable. The assets of the Takaful fund shall be kept separate from all other assets of the operator. This means that the fund of the entrepreneurs of a Takaful company should not be amalgamated with the Takaful fund created by the participants of a Takaful scheme.

When a Takaful scheme is operated on the basis of mutual or on the basis of cooperative principles, any surplus or deficit of the Takaful operation has to be shared by the participants, or the members themselves. But when a Takaful scheme is being operated on commercial basis, the surplus of Takaful operation has to be shared between the operator and the participants in accordance with the principle of Mudarabah. The sharing of such surplus may be in the ratio as agreed between the contracting parties. The participants are entitled to a share of surplus as the providers of the fund and the operators are supposed to have a share of the surplus as the entrepreneur and managers of the fund.

When a contract is made between the operator of a Takaful scheme and the participants of that scheme, the concept of Tabarru (donation) is incorporated in it. This means a participant will agree to relinquish a certain amount of Takaful contributions to fulfill his obligation of mutual help and joint guarantee should any of the fellow participants under the scheme suffer a loss caused by specified perils and or hazards of life.

3. **What is the Nature of the Takaful Contract ?**

The Holy Quran stresses the importance of justice, and justice must prevail in everythings that a Muslim does. Although conventional insurance, by compensating the few unfortunates through their time of disaster and need may seem to fall within the scope of the phrase, to some it has undoubtedly evolved into a profit-making venture which violates the spirit of Quran's teachings. To be successful, the management quite often engage in situations which expose their pool of funds to some calculated risky investments to secure high returns-which, of course, is perfectly accepted and even expected in business situations. This activity, however, contains the element of gambling(Maisir). In addition, when purchasing a conventional insurance policy, the policyholder is assured of promised returns at the end of the insurance term if timely premium payments are made. This, in its own, may defy to spirit of Shariah law prohibiting a predetermined return or riba. Many believers of Islam, accordingly, shun conventional insurance. The word, Takaful, originates from the Arabic "Al-Takaful" where much emphasis is placed on the issues of "Joint Benefit" and "Shared Responsibility". Accordingly, the distinct character of this form of insurance is that the contract is based on the virtues of co-operation, mutual help, shared responsibility and benefit, while all aspects of the contract must be transparent to all involved. The basic motive for Takaful under the Islamic value system, then, is to bring "equity" to all parties involved. Profit earning should not be the main goal, rather, helping other policyholders through bad times, sharing the misfortune while sharing the profits, if any, is the objective. The management of Takaful funds, therefore, are to exercise prudence when making investment decisions and must not subject such funds to potentially high return/high risk situations. To grasp the nature of Takaful fully, one should consider the element of Tabarru-the fact that in accordance with the principle of Joint Guarantee to help others, each policy holder willingly agrees to give a portion of his/her paid premium to other policy holders who are struck by a mishap and may be in need of financial assistance. This includes taking on the responsibility for safeguarding a deceased's (assured) dependants from unexpected future risk-the basis of life insurance as prescribed by Islam. The claimants, in turn, must abide by the true spirit of Tabarru and should realize that the amount paid to them has, necessarily, come from fellow policyholders. As such, they should try not to indulge in any money-making, self-profiting activities which potentially may be detrimental to the interests of the other policyholders. In the case of the Islamic life insurance policy, the assured will appoint absolute beneficiary(s) of the policy along with nominee(s), who acting as a trustee(s), would receive the benefit and would distribute them among the heirs of the deceased assured according to the principles of Mirath (inheritance) and Wasiyah (bequest). A nominee under conventional insurance is regarded as a definite beneficiary, while a nominee named in a Takaful contract, is a mere trustee of the claim. The heirs of the assured are each entitled to a share of the claim according to the principles of inheritance and bequest. The National Council of Muslim Religious Affairs in Malaysia, for example, by issuing a Fatwa confirmed in 1997 that the nominee is only a trustee of the insurance claim. To claim the benefits of a life insurance policy, only proof of death is needed. The cause of death, whether natural, accidental or even unlawful, does not matter, as it is the will of Allah that determines death of all creatures. In the event of suicide or death due to other crimes, for example, the assured is solely accountable to Allah for his own wrongful act. Neither the assured nor his beneficiaries should be deprived of

other rights and claims as a result of this criminal act. In the event that the assured is still alive upon the maturity of his policy, it is his right to claim from the insurer the total amount of premiums(save the tabarru amount) paid together with a share of the profits made. In addition, he will also receive bonus payouts and dividends according to the company's policy. Should the assured die before the maturity of the policy, the nominee(s) has the right to claim the total paid premiums except tabarru contributions and the share of the profits made. In addition to the bonus and dividends that he will also receive according to the company's policy, a donation from the company's charitable fund according to the financial condition of the assured's beneficiary may also be given. The concept of Al-Mudarabah, is inherent in Takaful which prescribes that all policyholders must agree to share the profits or losses from the undertaking and must be certain that profits, if any, are not ill-gotten money. Each concerned party in the Takaful contract the insurer, the assured, agents and management will take a share from the profits of the business.

4. **What is the basic concept of Takful ?**

The basic concept of takaful is the combination of both "tabarat" (donation) and mudarabah(profit and loss sharing) contract. The primary contract which binds the participants is the contract of tabarat as they mutually agree to help each other financially when any one of the group suffers from defined risk. At the same time all the participants agree to invest the pool of fund thus collected. The main contract is the contract of tabarrat. The elements of "gharrar" (uncertainty) and "Jahala" (lack of knowledge) are irrelevant as these two elements do not affect contracts which are gratuitous in nature. The basic aim of contributing to the common fund is to provide financial assistance to the one who suffers from defined risk. The profits are shared between the policy holders (participants) and the takaful operator as entrepreneur. While the conventional insurance basically is a contract of buying and selling, the takaful contract is based on the principle of Al-takaful and Al-Mudarabah. Al-takaful means the act of a group of people reciprocally guaranteeing each other, Mudarabah is the commercial profit sharing contract between the providers of fund for a venture and the entrepreneur. Therefore, the distinct character of this form of insurance is that the contract is based on the virtues of co-operation, mutual help, shared responsibility and benefit. The basic motive of takaful under the Islamic value system, then is to bring equity to all parties involved.

5. **Why Takaful has emerged ?**

Takaful has emerged as an alternate of conventional insurance. Takaful has grown as a form of protection against the risk of loss. Takaful is now being operated in Muslim societies mainly because it is necessary to protect each and every member of the society from any unexpected negative change in life, and wealth that he has. This is also necessary to protect the members of the society from unforeseen losses arising from legal liability. The system of protecting one from an unforeseen loss or damage is not a new concept that people just learnt about. Islamic societies have always collectively assisted their members, both in cash and kind, and when they have been required to incur some usual or additional expenditure on deaths, births, marriages etc. The Arabs even in the pre-Islamic days tied by blood relationship considered to meet the loss of any individual member, including his liability towards the payment of "blood money". They were obliged by custom and tradition to come to rescue of a fellow tribe and take

suitable measure to cover losses or liabilities collectively. This took the form of mutuality and gave rise to the custom of losses being shared by the group as a whole. Takaful has emerged as an alternate to insurance, because insurance and risk management are now being used in every sphere of human life and specially because of its tremendous importance to modern trade, commerce and industry. Because of the important role of insurance in the day today life and business ventures, the legal and contractual aspects has been the subject matter of detailed studies by Islamic scholars. The scholars have come to different views, opinions and conclusions. A few of them have approved all forms of insurance as permissible subject to certain limitations and qualifications. Other have totally disapproved any form of insurance contract because it includes an element of "al-gharar" (uncertainty and lack of clarity) "riba" (interest & usury) and "maisir" (gambling). However, most of the Islamic scholars have opined that the present day western oriented insurance contract does not in its present form, conform to the Islamic Shariah. This is why Takaful has emerged as an alternate mechanism of handling risks.

6. **How Takaful suits in Islamic Economy ?**

Islam is the second largest religion in the world with one and quarter billion followers. In all, Muslims form a majority of the population in over forty countries. Muslims live in 184 countries comprising about 20% of world population. Islamic countries and other countries with a significant Muslims in the recent past have encouraged the provision of financial services, including insurance, under Islamic principles. As a result more than sixty Takaful/Islamic Insurance companies have been established for providing insurance coverage both in the life and non-life sectors. These insurers generally known as Takaful operators are found not only in Islamic countries but also in Europe, North America and Australia. This type of modified insurance mechanism is expected to further influence the supply of and demand for insurance in the Muslim community. Takaful has grown not only as an innovative financial instrument, but also on religious principles. The purpose of religion is the well being of mankind. Islam as a religion seeks to order human life so as to make it actualize the pattern intended for it by its Creator. Islam is not only a religion but an ideology in the sense that the Shariah, its law has given the Muslims a pattern of life with which to order their lives. The Shariah is comprehensive, embracing all human activities, defining man's relations with God and with his fellow men. The Shariah grew out of the attempts made by early Muslim as they confronted immediate social and political problems to devise a legal system in keeping with the code of behaviour called for by the Quran and the Hadith. The purpose of Islam is always to inject morality into the fabric of human relations. How the Muslims earn its live hood, how he spends his wealth and how his wealth is to be disposed of after his death all these are the stuff of Islam. In Islam, the human aspect is more important than the material one. It relies more on moral, ethical and human aspects than on the material aspects. This is something unique in the Islamic Economic system.

Prophet Mohammad said,

" One who eats to his hearts contents, while his neighbor starves, is not a Mumin"

Helping neighbours, poor relations and the distressed contribute to an exploitation free society based on the principle of brotherhood .

Understanding fundamental principles of Islamic Economic System is necessary in order to have a better understanding of the role of Takaful and its suitability in the Islamic Economy. For example, right of private ownership accorded by Islam is not absolute and unconditional The ownership is a kind of trust only. An individual may privately own and manage any kind of wealth, but he can not do with them whatever he likes. He is to regulate the uses as per the Shariah Law. An individual can make joint investment to earn profit from his investment. Takaful is a means whereby investments of surplus funds are made by the Operators and profits are distributed to the Participants i.e. to the owners of the capital. Another fundamental principle of the economic system of Islam is that it stands for equitable distribution of wealth. Islam encourage people to be selfless helpers for one another by arousing in them feelings of sympathy. Takaful is a system where people are encouraged to contribute money for mutual help in times of need. Thus Takaful comes in for help of distressed fellow by means of mutual cooperation and joint guarantee. The Islamic Economic system combats the accumulation of wealth and its concentration in the hands of a small minority. The Islamic Law of inheritance provider for the shifting and distribution of wealth in a manner unknown in other legal and economic systems. It divides the estate of the deceased over a wide range of beneficiaries and not on a single heir to the exclusion of other. The Islamic system requires that wealth should be utilised as an instrument to serve the interest of the community at large. In the Islamic way of life, some special kind of levies are imposed. The objective behind them is to provide financial assistance to the people of lower income bracket from the money of the relatively better off people. In Islam, there are a various kinds of compulsory levies ranging from very high rate of 20% of the income to the minimum of 2.5% of income. These are to be collected for the poor and needy. This is an automatic mechanism of balancing income in the society. Islam makes it obligatory on every Muslim who possesses a certain limit of income upto one year to pay a certain percentage of it for the destitute and needy. This is called Zakah. It is so important part of Islam that the instruction of the payment of Zakah always comes next to Salat (prayer). The prophet described Zakah to be one of the five pillars of Islam. The Takaful companies which create fund to meet unforeseen loss of individual and also the contributions and donations made by the Participants in a Family Takaful Scheme become Zakatable asset. Takaful Operator, therefore must arrange payment of Zakah out of these funds for the poor and the needy. There are broadly eight heads of expenditure of Zakah each of them include people in need of financial assistance. All the poor and destitute temporary or permanent are covered by the financial assistance system of Zakah. Takaful system, therefore, not only provide security for the people who participates in the schemes of Takaful but it is also a means for providing financial assistance to the needy people of the community and a mechanism of obligatory social security. Zakah is of course not a substitute of income tax. It is imposed on capital. Zakat has to be levied annually whether it is invested or not. Therefore, it is prudent for the owners and managers of the fund to invest it in production purposes. As a result, it induces that all the resources and wealth of the economy are employed continuously in the productive activities. By implementing Zakah system within the mechanism of Takaful, it helps develop the economy towards growth and prosperity.

7. **Why study of Islamic Insurance is important ?**

We have been discussing about Islamic system of insurance since long. The reasons for such study may be summarized as follows:

a) We are convinced that in the modern age there are several essential social and economic values of insurance.

b) We understand that the insurance as being practised in the capitalistic economy have several shortcomings and not in conformity with the Islamic Sheriah.

c) We feel that a new model of insurance can be practised under the Code of Islamic Shariah, which is based on the Islamic concept of Al-Takaful, which means "Joint Guarantee"

d) We observe that insurance and gambling are basically different from each other and the principles of Islamic law permits the idea of covering calculable risks.

e) We emphasize that the mechanism of new model of insurance (Takaful) could serve the economy in such a way so that it would bring better results for both the insurers and insureds in particular and for the society in general.

Based on above facts we must try to analyze how and why Islamic model of insurance on the basis of "mutuality" concept can bring good results for all involved in the mechanism.

8. **What are the Distinctive Features of Takaful System ?**

One of the prime distinctive features of takaful in comparison to conventional insurance lies in the legal relationship between the contracting parties. The relationship between the insurer and the insured in the conventional system is that of buyer and seller. Insurance policies are sold to the policyholder and insurers want to maximise their own gain by selling the service of insurance. But in case of Takaful, the operators act as trustee and or manager of the participant's fund. As manager or trustee, the operators are entitled to have remuneration which is given by the participants as share of profit arising from operational surplus of the Takaful fund. Another fundamental distinction between Takaful and Insurance is the laws and principles governing the systems of takaful and insurance. Islamic insurance is operated on the basis of Divine laws of Islam and the sources of these laws are the Holy Book as revealed to the Prophet, interpretations of the Quranic law, traditions of the Prophet, practices of the companions of the Prophet, consensus among the Islamic Scholars, juristic opinion of Islamic scholars by analogy, customs, precedents of the Muslim society etc. Conventional insurance is operated basically by the law of contract, law of liability, Act of the parliament, common law and the customs or usages which have been developed since the early primitive era until today. Rules and regulations of conventional insurance system are derived from Statutes, case laws, judicial precedent, customs and practices. On the other hand, rules and regulations of Takaful are based on the primary (the Quran and the Sunnah) and secondary sources of Islamic law i.e. relevant Shariah based case laws, juristic opinions and Shariah based statutory provisions if any. Insurance practice under common law and western laws evolve round the elements of interest, profit maximization and sometime exploitation; whereas under Islamic law modus operandi of Takaful is based on an interest

free system of profit & loss sharing. Modus operendi of Takaful is based on the principles of Shariah. It is operated on the principles of mutual cooperation, solidarity and brotherhood. It is practised basically on the principles of Mudarabah (profit & loss sharing) based financing which is an alternative to the interest based financing. Thus the funds generated from the insurance business belong to the insurance company, but the funds generated from the contribution of Takaful schemes belong to the participants (policyholders). The funds of insurance company can be invested in any scheme or project as per relevant insurance laws and regulations, but the funds of a Takaful business should not be invested in projects until and unless it is supported by the Shariah discipline. The entire procedure shall comply the guidelines of the Shariah and not by any unethical/unIslamic practices.Takaful practice under Islamic principles posses certain fundamental characteristics. However the main difference between a Takaful scheme and conventional insurance lies in modes of investment and sharing of surplus. A Takaful operation is based on the principles of Mudarabah financing technique, whereby the parties involved share the profits with an agreed portion. This makes the Takaful operation a Riba-free transaction. Muslims believe that Allah has prohibited interest (Riba) for the obvious reason of its unfairness. The Mudarabah financing technique is considered by Islamic Jurists as a fair and just transaction and presents a fair commercial dealing. It is considered as the best alternative to the unfair interest based transaction. The ultimate object of an insurance company is to make maximum profit. Sincerity of purpose is not an essential requirement for a valid insurance. But the ultimate object of Takaful is to achieve the pleasure and blessings of the Almighty Allah. According to Islamic teachings, deeds of human being is evaluated by Allah by its real intention and therefore, it is the prime duty of the believers to perform all their activities only to seek the pleasure and blessings of God by performing good deeds with utmost sincerity and only according to the path prescribed by the Quran and the Sunnah. In order to protect the Takaful operations from being involved in their practice with some elements of the conventional system, a council of Shariah experts need to supervise all the aspects of a Takaful operator. This is necessary to make sure that, the Takaful schemes are being operated on the basis of Shariah principles. The Shariah Supervisory Council provide necessary consultation for the Takaful operations for development of Takaful laws, regulations and practices justified by the Shariah sanctions.

9. **What are the Features of Islamic Insurance company ?**

An Islamic Insurance Company should have following distinctive features:

a) The policy holders will have the right to participate in surplus profits

b) The policy holders will be liable to contribute additional amounts if the initial subscriptions (contributions) made during a particular year are not sufficient to meet all the losses. This is only when it is on mutual basis.

c) The policy holders should be given adequate representation on the Board of Directors of the company and have the right to scrutinise the company accounts.

d) The company would invest its funds in sources which are not forbidden by Islam and should not indulge in the harmful and forbidden practice of Riba in any form.

e) The company would maintain two separate and distinct accounts. One known as the policy holders account and the other the shareholders accounts. The policyholders account is credited with all the contributions made by the policyholders and their share of profits on investment of funds. The policyholders account is debited with their proportion of service charges and claim. The surplus after the establishment of necessary reserves is distributed amongst the general reserve. If there is no general reserve and the amount of the general reserve does not cover the deficit fully, such deficit is met from the shareholders reserve and capital in the form of interest-free loan and to be recovered form the future surpluses. The shareholders, however, should not participate in any part of the surpluses of policyholders account. The income derived from the investment of the share capital is credited to the shareholders account and the surplus left after meeting their share of current expenses etc. is distributed amongst the share-holders.

f) A Zakat fund will be developed by way of charging 21/2% annually on the share capital reserves and profit.

There should be a Shariah supervisory Board. The Board will be responsible for supervising the day to d ay functions of the company in the light of Shariah.

10. **What are the modes of Investment of a Takaful Company ?**

An Islamic Insurance Company shall have to be guided by the relevant law of the country, but at the same time it must use the invisible funds in financing and participating in permissible economic activities according to Shariah provided modes on profit and income sharing basis. Therefore, investment of Islamic Insurance companies should be made as per following modes :

a) Musharaka (Sharing profit & loss on a productive investment).

b) Mudharaba Bond (project finance for a fixed time with profit being shared)

c) Real Estate

d) Deposits with Islamic Banks.

e) Stock market within Shariah limits.

f) Unit Fund.

g) Cooperatives & Mutual Enterprises.

11. What is the objective of Islamic Life Insurance ?

Under the Islamic System of life insurance, the members voluntarily may join under a scheme of savings plan on Mudaraba basis. Under this plan each member contributes to a common fund. The fund thus collected is invested as per Islamic injunctions. Part of the profits out of these investments are added to the individual account according to the contributions made. The losses if any, are also borne by the members. A reserve is built up from the profits earned for payment against death, and disability of the members as agreed before. The individual member who is being paid for death and disability get compensation from the common reserve fund and not debited individually to the accounts of the members. It may be noted further that for each different age groups (at the time of entry of members) the funds are maintained separately and only the persons of normal health are accepted as members. Although the traditional life

Insurance system also works through a system of resource pooling, the insured does not enter into any mutual agreement with insurance company for sharing profits and losses. The idea of mutual help is absent in western system of Insurance. An insured under western system of Insurance gets his contracted amount of claim exactly even if the pooled fund is too small in relation to the aggregate of claims. The insured also can not claim profits. The real objective of Islamic system is in fact not primarily the loss protection but sharing of resources. The members under the suggested scheme are in real sense the investors of a savings plan, whereby the members agree to share their resources for mutual protection against certain perils of life.

12. **How Family Takaful Companies Operate ?**

A member or participant of family Takaful scheme will enter into a formal contract with the company offering the scheme on the principle of "Mudaraba". The members will be required to pay a fixed amount at regular intervals. The amount of members contributions (on instalment basis) will vary according to members age at the time of entry into membership and the mutually determined amount of the "fund" to be built up within a fixed period. Each instalment of the contribution will be credited into two separate accounts, the one being maintained in the name of each " individual" member and the other would be a "collective" account of all the members of particular savings scheme. The "individual" accounts will be credited by major portion of the instalments paid by the members and a small fraction of the instalment amount (say approximate 5% only) will be credited into the "collective" account. The amounts so deposited into the "collective" account forms the "special fund", out of which compensations will be paid to a member's heir in the vent of his death and failure to contribute the agreed amount as per contract. In fact, the deceased member's heir will get the total amount of his contribution in the "individual" account along with his share of the profits from the investment of the instalments into that account. In addition to that the outstanding instalments will be paid to him from the "collective" account. When a member pays all the instalments of the agreed amount and survives, he will be paid back the total amount credited into his "individual" account plus his share of profit credited into that account. In additions to that his net share of the "surplus" as may be assessed in the "collective" account will be paid to him. If a member does not want to continue with the saving scheme, can withdraw his contribution from the individual account along with the share of profit by giving due notice. But he may not be entitled to any share of the net surplus from the collective account.

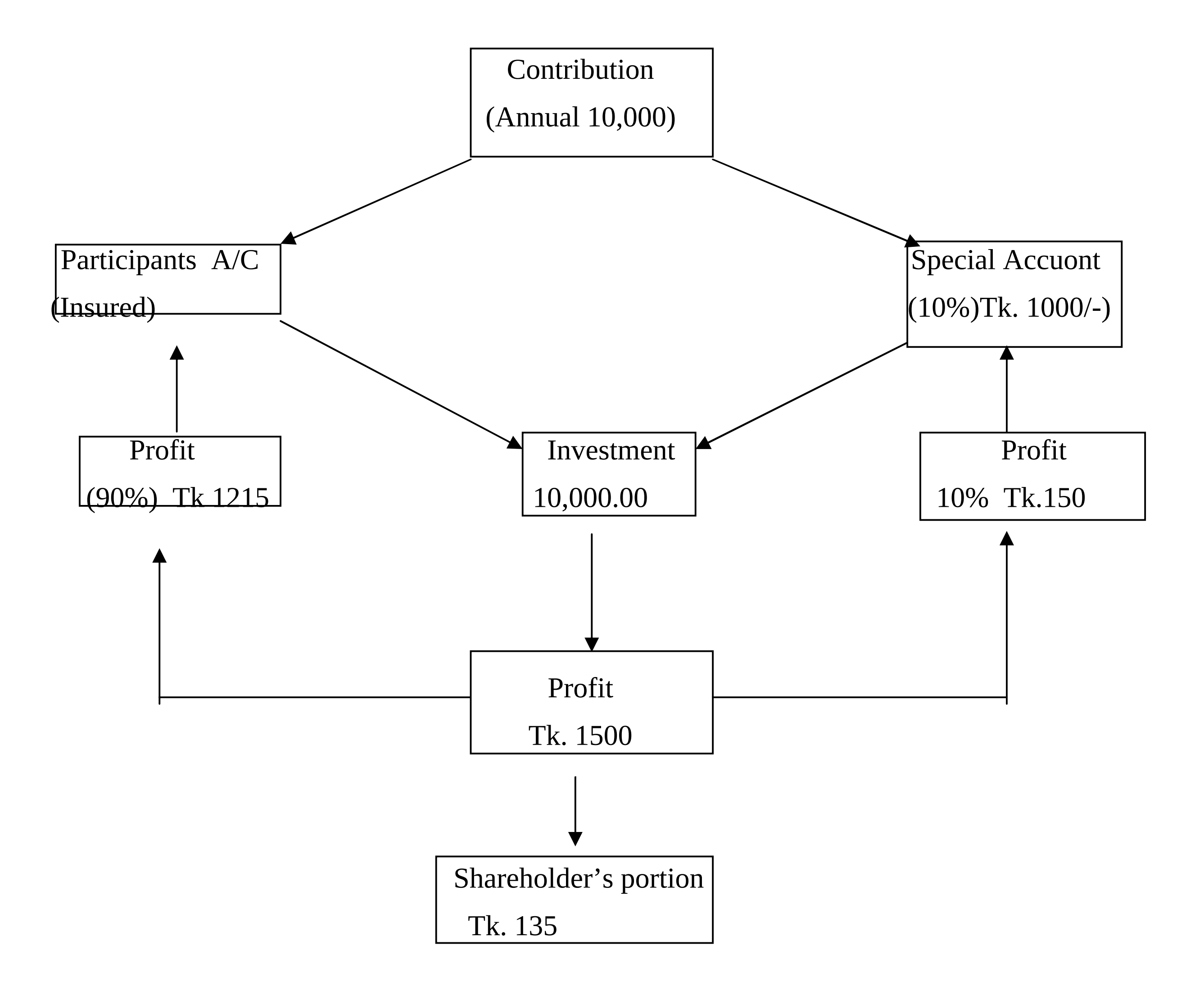
In view of what has been described above about the alternate saving scheme of the life insurance under the Islamic framework, it may be observed that the scheme is a unique plan for future savings and has with it a compensatory element to cover the risk of death of a member. In this respect it may be noted that usefulness of life insurance as means of savings is not very attractive proposition because there are other superior methods of saving. Further, the inflationary effect of the economy eats away the value of those savings more quickly. Over a period of time, the purchasing power of accumulated saving is much lessened. But this can be overcome by the alternate formula as prescribed under the Islamic framework, as the accumulated funds of individual are being invested on the basis of profit and loss. As a result, by efficient management of the fund, the value of the saving will rise with the rise of general price level and thus can maintain a constant level of purchasing power of the savings fund.

13. **What is the modus operandi of Islamic Life Insurance ?**

The modus operandi of Islamic Insurance companies operating life business are almost similar but some clarification is needed, Life policies are issued in the name and style of Family Takaful Scheme. The participant or the policyholder of a family takaful plan should pay the agreed amount of instalments on a regular basis. Each instalment paid by the participants are divided and credited into two separate accounts namely "The participants Account, and "The Special account". Normally the major portion of the instalment amount say 90% is credited to the Participants Account and balance 10% is credited to Special Account, the deposits are paid back to participants as per terms of the contract with profit. The amounts which are credited in the Special Account are meant for those participants who will not be able to pay full instalments because of their early death. Thus the company will be able to pay takaful benefits to all fellow participants who become members of the scheme. The amounts which are credited into these two Accounts are invested as per Shariah Code and profits are shared between the Participant and the Company in an agreed ratio. The major portion of the profit say 80% is paid to the policy holders and the company is entitled to get the balance amount of the profit only. In the event of surrender of the policy, the incumbent participant will receive the proportion of his takaful instalment which had been credited to Participants Account together with his share of profits accumulated up to the date of the surrender. But they will be not entitled to get any refund from the Special Account.

If a participant expires before the maturity of his family takaful scheme his/her heirs will be entitled to get the total amount of the instalments deposited into participants Account. His/her heirs will also be entitled to the total outstanding instalments which would have been paid by the deceased participant, should he survive. If a participants is alive till the date of maturity of the takaful scheme, he is entitled to get the total amount of takaful instalments deposited in participants account and the surplus if any which is available in the special Account as per last valuation of this Account before the maturity date.

We can illustrate this in the following diagram of family takaful of Tk. 2,00,000. @ Tk. 10,000 annual contribution for twenty years.



In the above diagram it has been assumed that for a takaful plan of an individual for twenty years terms the participants should contribute annually 10,000. At the end of the year the participants Account will be credited with Tk. 10,215(9000+1215) and the special Account will be credited with Tk.1500/- (1000+150). Every year these two Accounts will be credited with similar figure. The profit amount will increase depending upon accumulated figure and return on investment. If the participants want to surrender i.e. if he is not willing or are not capable he gets back his money credited in the Participants Account. For example, if 'X' a participant wants to surrender, at the end of the fifth year of the plan, he gets back all the credits along with the profit in Participants Accounts at the end of fifth year. At the maturity i.e. at he end of the 20th year, he will get all credits & profit. **Even if a Participant expires after payment of a single annual contribution of taka ten thousand, his nominee/heirs will get under this scheme guaranteed outstanding balance of taka 1,90,000.00 plus his portion of Participants Account along with profit i.e. Tk. 10215 Total Tk. 2,00,215/-.**

14. **What are the distinctive features of family Takaful Scheme ?**

The distinctive feature of the Family Takaful scheme in comparison to life insurance policies is the separation of the investment portion from the portion which is set aside to cover the risk. The profit from the investment of Fund in participants account is shared between the Participants and the Takaful Operator. The most significant distinction of the takaful business is the sharing of profit. Therefore, accuracy and transparency of the Takaful accounting system is of prime importance. The share of profit of the participants account is credited into the individual participants account on yearly basis and an yearly statement is sent to individual participant. A Participant is required to nominate someone as an executor over the benefits of the Takaful scheme and distribute such benefits as per Islamic law of inheritance after his demise. The nominee receives the benefits only as a trustee. If the nominee is a non-Muslim he is regarded as an absolute beneficiary. However, a Muslim can assign the benefits to someone as a donee in which the benefits under the scheme are given in advance as Hiba(gift) in favour of the donee. In this case, the donee becomes the absolute beneficiary of the Takaful benefits.The conventional life insurers offer bonus or profits to a special type of policy holders subscribing the with profit policies. The declaration of profit is dependent upon the valuation of the life fund. The rate of bonus vary from year to year. On the other hand Takaful contract specifies from the very day of the contract how the surplus from Takaful Investments are to be shared between the Takaful Operator and the Participants. This is done in accordance with the principle of Mudarabah (profit sharing). The profits are shared in the fixed ratio as agreed between the Operator and the Participant. In the conventional life insurance policy the agency commission is paid out of the premiums collected from the policyholders. But a Takaful Operator considers agent as part and parcel of the operator, and, therefore, agency commission is paid by the operator out of the shareholders fund. However when at the time contract, it is mutually agreed between the operator and the participants that the agency commission will be paid out of participants contribution the Takaful operators are allowed to pay agency commission as per agreement either fully or partially. In the conventional life insurance contract the surrender value under the policy will be much lower than the actual premiums paid by the policyholder. But under a Takaful contract, in case of a surrender of the scheme, all contributions of the participants deposited to Participants Account (investment portion) will be refunded alongwith the profits made from investment. The proportion of his installments which he donated as “tabarru” shall not be refunded . Since tabarru is only a negligible portion of the total amount of the installment amount the surrender value of the participants will be near to all the installments he has paid. Moreover, the participants are allowed to withdraw partially from the money deposited in the participants account. Under the conventional life insurance contract, the beneficiaries of the policyholders are not entitled to any claim, if the policyholder commits suicide within first two years of the contract. Under Takaful scheme, the beneficiaries of the participant will have the right to claim benefits from the operator even if the participant has committed suicide or has been killed while committing a crime. Under the Takaful scheme the contributions made by the participants should not be forfeited, even for a breach of utmost food faith. In case a participant discontinues payment of installment and ask for a surrender value, all contributions deposited in the Participants Account should be refunded to the participant along with proportion

of up to date profits made from investments. The operators, however, may charge reasonable fee for withdrawal from the scheme.

Under Takaful operation, the accounting for Shareholders Fund is maintained separately from the respective Takaful funds. Income of Takaful operator are derived from investment return of shareholders fund and the share of profit from Family Takaful fund. Operating expenses such as staff cost, establishment cost and administrative costs are met from Shareholders Fund.

15. **What are the Arguments against and for life insurance ?**

Those who think life insurance is not acceptable put their arguments as follows:

(a) There is no justification for a person, giving a part only of a sum, to be entitled to get the whole in case he dies. This is nothing but gambling.

(b) The system of life insurance is based on Riba.

(c) Life insurance pays for something which can not be valued or indemnified.

(d) It does not befit a Muslim that he should have faith in life insurance because it may provide maintenance to his heirs.

(e) The policy amount is paid to the nominee. This is contrary to the laws of inheritance in Islam.

On the other hand arguments for life insurance are as follows:

(a) Insurance, in all its kinds, is an example of cooperation of a group of people and helpful to society. Life insurance is beneficial to individual and there is no harm in getting indemnification from the group.

(b) Life insurance organizations can be run and organized without the element of Riba.

(c) There is precedence in Islamic history of compensating death by way of paying “blood money” and, therefore, value of human life can be measured for compensation purpose.

(d) Under life insurance scheme people deposit an amount with an insurance company with the intention of saving a desired amount. But the scheme ensures that even on death of the savers, the shortfall of the desired amount of savings be compensated from a common fund. Therefore, it is in no way a reliance on insurance instead of Allah.

(e) The system of nomination of life insurance can be suitably modified and amended to make it non-conflicting with the Islamic laws of inheritance.

16. **How Takaful is beneficial to the Society ?**

It has been estimated that annual overhead cost of property insurers account for about 30% to 50% of their earned premium. This means a major portion of the premiums paid by the policy holders would be used for doing the business and earning profit for the shareholders. Therefore, it is obvious that the insured and the society obtain the benefits of insurance jointly against the cost of obtaining this service. However, it can be seen that the cost of operating the insurance business will be comparatively lower under the Islamic system of insurance. It is well understood that when the surplus (profit) is shared by the policy holders, the cost of obtaining the service would be lower in the Islamic Insurance (Takaful)

system at least to the extent of surplus fund being returned to the policy holders.

Moreover, the insureds in the conventional companies are to bear the costs for losses which are intentionally caused and or exaggerated. Although, there are no reliable estimates as to the extent of losses that are intentionally caused, it is obvious and insurers are well aware that good amount of claims are being paid against losses which are intentionally caused by some unscrupulous insureds in order to collect on their policies. It is also observed that there is the tendency to exaggerate the extent of damage and losses that results from purely unintentional loss occurrences. There are a lot of examples. When it is known that an insurance company is involved there seems to be an unmistakable tendency to exaggerate the extent of loss by surveyors, repairers, medical practitioners, solicitors as the case may be. This is done in collusion with the dishonest insureds. It is expected that the costs of exaggerated and intentional losses would be much lower, if any, under the Islamic insurance system. This is mainly because there would be insureds under this system are those God-fearing individuals who want to lead an honest life and as such should not indulge to such unfair and unethical practices for the temporary gains in the worldly affairs. Since, the Islamic insurance companies will be basically operating on the principles of "Mutuality" it is very logical that the net underwriting gain of Islamic Insurance companies will be higher compared to corruption prone conventional insurance.

17. **How the policy money may be distributed ?**

Under Islamic Law, a beneficiary in a policy should have an insurable interest in the subject matter of the policy and whether a person has an insurable interest in a policy or not, can only be determined by the principles of Mirath . The Takaful operations in Malaysia require the proposer of the life policy to complete a Wasiyah form in which the proposer has to name certain specific persons who would subsequently have an insurable interest in the policy. According to Islamic Law, the benefits over a policy shall form part of the estate of the policy owner and, therefore, the nominee in a policy shall be regarded as a mere executor and not an absolute beneficiary. Moreover, the policy money will be subject to his (policy holders) debt and to be distributed among the beneficiaries of the deceased policyholder according to the principles of Muslim law of inheritance and Will. The procedure that has to be followed by the nominee may be discussed in brief. The total policy money received by the nominee should be taken into account alongwith other wealth and property left by the policy holder. If there is any unsettled debt of the policy holder, the amount of debt would be paid first. The funeral expenses of the deceased should be met from the wealth & property (including policy money). Thereafter the Wasiyah if any should be honored and meet only up to one third of the total property. After the settlement of all these obligations, the remaining properties of the policy holder should be distributed according to the principles of Mirath (inheritance law of Islam).

18. **How co-operative clause is incorporated in Takaful contract ?**

An Islamic Insurance Company is established on condition that its co-operative nature be made evident. This necessitates clear stipulations in the insurance contract certain additional clauses to signify that the premiums paid by the insured are grants from his to the company to be remitted to fellow contributors in need of assistance according to the regulations agreed upon. Therefore, it has

been suggested that certain special clause should be added to the insurance contract to signify its co-operative nature. The additional terms provide the insurer the right to revert back to the insured for additional premium and the right of policy holders to share in the surpluses. The insurer also enjoys the right to invest the surplus fund in any way that it deem fit in projects and other fields of investment as allowed by shariah and under the relevant insurance rules/regulations.

Islamic Insurance Co. (Sudan) has incorporated this principle by way of inserting additional clause in the policy condition as follows:

i) Co-operative (Mutual)Clauses:

"The insurance granted under this policy is subject to company's Memorandum and Article of Association which provide interalia that the company shall transact business on a co-operative basis in accordance with the subject of the Islamic Shariah. The Company accordingly maintains a distinct and separate account for its policy holders known as the policy holders account. The policy holders Account is credited with all the premiums paid by them gratuitously and debited with their share of service charges, claims and the surplus, if any arrived at after making provision for depreciation, bad and doubtful debts and establishing traditional technical services at the end of each financial year shall be treated as follows:

a) The Board may set aside all or part of the surplus as general reserve or other special reserves and such reserves shall be considered as gratuity from the policy holders.

b) If whole of the surplus has not been set aside as reserves the balance shall be distributed amongst the policy holders in proportion to t he surplus generated by the premiums paid by them."

19. **What are the functions of shareholders in Takaful system ?**

The shareholders are entrepreneurs who have taken upon themselves the responsibility of organizing a takaful activity for the benefit of participants who have willingly agreed to the scheme. The shareholders are trustees of the participants who will be responsible to organize a takaful activity which is well-defined in terms of obligations and benefits.The shareholders will be mudharabah partners of the participants as far as the funds generated from the contributions of the participants are concerned. Any profit derived from the investments of such funds will have to be shared between the shareholders and participants according to some pre-agreed ratio. The shareholders need to negotiate with the participants as far as the allocation of the fund into the investment portion after the portion for mutual benefits that will be used to pay out compensations. The latter portion is known as tabarru which is derived from the word al-birr meaning righteousness or beneficial. This portion is dependent upon the extent of risk involved. The higher the risk, the bigger is the portion allocated for this purpose. The shareholders also play the role of management for which they have to work out the capital to start the takaful activity and hence has the right to earn a fee. Of course, in contemporary setting, the shareholders will appoint professionals to manage the enterprise, and finally, the shareholders have to be responsible to the participants in ensuring that every activity of the enterprise is in tandem with

Islamic principles. This is indeed necessary because the participants may not be able to assess all information pertaining to the operations of the enterprise.

20. **What is Shariah Supervisory Board ?**

Shariah Supervisory Board is a separate and independent forum comprising a number of Islamic Jurists known as "Faqih" who are experts and well-versed in "Fiq al moamalat" meaning Islamic Shariah principles and codes on financial transactions. "Non-Faqih" individual can also become a Member of this Board on condition that he must be an expert regarding the rules and regulations of the Islamic Financial Institutions and side by side he must have the knowledge on "Fiq al moamalat". Shari'ah Supervisory Board is entrusted with the tasks of issuing necessary guidelines for carrying on the activities of Islamic Financial Institutions, and its supervision and surveillance so as to ensure proper implementation of Shari'ah codes and the decrees issued by the Shari'ah Supervisory Board are mandatory for them.

21. **Why Shari'ah Supervisory Board is necessary ?**

It is mandatory to form Shari'ah Supervisory Board especially in those countries where financial institutions have been Islamised by the State initiative. There are certain institutions where the constitution of Shari'ah Supervisory Board has been kept under the purview of their Board of Directors (Management Council).But the fact is that apart form legal bindings, there is an inherent moral binding. This inherent (moral) binding is a basic characteristic which exists in all Islamic financial institutions but not in vogue in the conventional ones. It is imperative on the part of Islamic financial institutions at least for the mental satisfaction as to whether Shari'ah Principles and codes are being properly implemented. There is no alternative to Shari'ah Supervisory Board who can give guarantee and assurance to all concerned as to whether there is any transaction contrary to Islami Shai'ah especially usury.

22. **What are the Qualifications of the Members of the Shari'ah Board ?**

Those who are quite well-versed in Islamic Shari'ah Principles especially with regard to financial transactions based on Shariah Codes are eligible to become the Members of the Shariah Board. Veteran Bankers, Insurance stalwarts, eminent economists and legal experts may be made the members of the Shari'ah Board. But as per Bahrain based International Institution - Accounting and Auditing standards for Islamic Financial institutions, Manama, Bahrain, such Non-Fakih Members may be included in the Shari'ah Board provided they are experts in the rules and regulations of Islamic financial institutions coupled with knowledge on "Fiq al moamalat" Such an arrangement may help settle Shari'ah matters in relation to the modern Banking & Insurance practices and prevalent laws by explaining the things before the Shari'ah experts and having knowledge on fiq al mua'malat, they can easily take part in the discussion and grasp the deliberation easily.

Chapter (VI)

Past, Present & Future of Takaful

1. What is the origin of Islamic Insurance ?
2. What are the backgrounds of present day Islamic Insurance ?
3. How the first Islamic Insurance Companies were formed ?
4. What is the current scenario of Islamic Countries ?
5. What role Takaful can play to the Muslim Ummah ?
6. How Takaful suits in Islamic Economic System ?
7. How Takaful is beneficial ?
8. How Takaful came into being in Malaysia ?
9. How Takaful was launched in Singapore ?
10. How Islamic Insurance had grown in Indonesia ?
11. What efforts have been taken for Islamising Insurance in Pakistan ?
12. What is the potentiality of Takaful Industry ?
13. What about the future prospects of Takaful ?
14. Is Takaful a viable reality ?
15. What is the Role of Government in Islamization of Insurance System ?
16. What are the hindrances of Islamic Banking & Islamic Insurance ?
17. How Islamic Bank and Insurance companies can cooperate for mutual growth and expansion ?
18. How Islamic Insurance can supplement the transactions of Islamic Bank.
19. Is there any move to foster the growth of Takaful ?
20. How Takaful can be made popular ?
21. How the superiority of Takaful System can be enhanced ?

1. What is the origin of Islamic Insurance ?

The earliest known history of a more specific Islamic insurance, is generally accepted as having been in the early second century of the Islamic era. At that time, Arab Muslim had started to venture out on long trading journeys to India, South East Asia as well as other countries and continents. Due to the nature of these journeys, they often faced risk of incurring losses, owing to natural disasters and other problems such as piracy. Using the Islamic principles of mutuality and co-operation, those Arab Muslim traders eventually agreed to set up

and contribute into a fund, which would then be used to compensate anyone among them who had suffered losses through any mishap.

2. **What are the backgrounds of present day Islamic Insurance ?**

There are many encyclopaedias justifying the fact that the nature of insurance practice had been originated from the ancient Arab practices, whereby it became a custom among the tribes of Arab that if any member of a tribe was killed by a member of different tribe, the heir of the victim would be paid with an mount of blood money as a compensation by close relatives of the killer. In one of the disputes, the Holy Prophet (SAW) decided as follows: “Narrated by Abu Hurairah (R), he said that once two women from Huzail clashed when one of them hit the other with a stone which killed her and the boby in the victim’s womb. The heirs of the victim brought an action to the court of the Holy Prophet (SAW) who gave a verdict that the compensation for the foetus to be a male or female slave while the compensation for the killed woman is a blood money (diyat) to be paid ;by the ‘Aqila’ (the relatives of the father’s side) of the killer. The practice of insurance based transactions could also be discovered from the period of the second Caliph, Umar(R). During the period, the doctrine of ‘Aqila’ had even been encouraged by the government to be practised by the people. Umar(R) had commanded that a ‘Diwan’ of Mujahideen be established in various districts and those whose names were recorded and contained in the ‘Diwan’ owed each other a mutual co-operation to contribute sincerely the blood money for manslaughter committed by one from their own tribe. Hence, it is presumed here that the application of the doctrine of ‘Aqila’ had further been developed during the period of the second Caliph of Islam. During the period of the nineteenth century Ibn Abidin (1784-1836), a Hanafi lawyer was the first person to discuss about the idea of insurance and its legal entity. He was also the first person to discover insurance in the context of a legal constitution, being no longer a customary practice. In the period of twentieth century, a well-known Islamic jurist, Muhammad Abduh issued two ‘fatwas’ which mentioned that an insurance transaction is like the transaction of Al-Mudharabah’ financing technique while the other was that a transaction which is similar to endowment or life insurance are legal.

3. **How the first Islamic Insurance Companies were formed ?**

With the establishment of the Dubai Islamic Bank and the Islamic Development Bank, as the starting point of Islamic Banking Movement, H.E. Prince Mohammed-El-Faisal-Al-Saud of Saudi Arabia took initiative f or the establishment of a number of Islamic Banks. In one of such initiatives in February, 1976 he held discussions with H.E. Gafar Nimeiry (the then President of the Democratic Republic of Sudan) and asked for permission to establish an Islamic Bank to be operated in Sudan. Executive and Legislative authorities in the Sudaness Government at all levels gave every encouragement and acceded to the proposal. On August, 1977 Faisal Islamic Bank was registered as a public limited company under the Sudanese Company Act 1925. When Faisal Islamic Bank was established the Bank authorities initiated studies on the establishment of a co-operative insurance company. In this respect the opinion of the Bank’s Shariah Supervisory Board was sought. The S.S.B. Studied the scheme at the first meeting. Studies continued and several steps followed. The Memorandum of Association and Articles of Association were prepared by the Faisal Islamic Bank authorities. The S.S.B. proposed some amendments which were implemented. The

S.S.B. ensured that the scheme was sound from Shariah point of view as well as feasible from practical point of view. Therefore, the Islamic Insurance Company Ltd. Sudan was incorporated as a Sudanese Public Company (under the Companies Act 1925) in January 1979. This is the first ever insurance company established in the world to transact business according to the Islamic Shariah. The entire authorised capital of this company have been subscribed to by the Faisal Islamic Bank. The company enjoys numerous concession and exemptions. All its assets and profits are exempt from all types of taxes. Further, the assets of the company are not subject to confiscation, nationalisation etc. The company is also exempt from the application of Acts regulating insurance in Sudan. In Malaysia, the Islamic Insurance Company was established as a private limited company (in accordance with Companies Act 1965) in November 1984 and started its operation from August 1985 as a composite insurance company. This was made possible by the Malaysian Government who in 1982, took a positive step by forming a special body known as the 'Task Force' on the study of the establishment of Islamic Insurance in Malaysia. This task force was formed on the basis of the recommendation of the National Steering Committee on Islamic Bank, which highlighted in its report to the Malaysian Government of the need for on Islamic Insurance. The Committee felt that it was necessary in order to cater the insurance requirement of the Islamic Bank which was about to be launched then. Members of the task force were drawn from personalities and groups representing religious scholars, legal experts, economic and insurance practitioners. The members of the taskforce visited a number of Islamic countries and also discussed with three Islamic Insurance companies already established or about to the established. Finally, in its report to the Government, the task force suggested that an Islamic Insurance company should be established in Malaysia as soon as possible. The Malaysian Government then promulgated legislation entitled as the Takaful Act, which regulates the Islamic Insurance (Takaful) of Malaysia. It may be of interest to note that in Malaysia the Islamic Insurance Company (known as the Syarikat Takaful Malaysia) is practically a subsidiary of Bank Islamic Malaysia Berhad, which owns 51% of the paid up capital of the Takaful company. The balance of 49% of the shares are owned by the various State Religious Councils and State Religious Foundations within Malaysia.

4. **What is the current scenario of Islamic Countries ?**

The exploitations by the colonial or imperialist nations of the world have now dwindled and almost disappeared in its old forms. But invisible plunderings are still creating much harm in the economy of the Islamic States. Invisible plundering through economic imperialism and exploitation appears to be more dangerous than the political one. The Muslims, in general throughout the world have lived in abject poverty among plenty for generations. Though most of the Muslim countries regained their political sovereignty, they do not posses economic sovereignty even now. Muslims in general, have forgotten their traditions, culture, laws, socio-economic teachings. They have been not practising Islam in their socio-economic affairs for their own betterment. Moreover, the Muslim world was kept divided and the resources of the Muslim world were not utilised for their own benefit but for building the economy and serving the interest of the imperialist exploiters. Many of the Islamic States have vast resources of men and material for their economic emancipation. Some of them have huge financial resources. The Muslim World has at its disposal resources which can be utilised for economic development. For example, Malaysia and Indonesia posses Rubber, tin, Timber and

Oil. The wealth of oil has been blessed to Iran, Saudi Arabia, Kuwait, U.A.E , Bahrain, Oman, Qatar, Iraq, Libya, Algeria, Morocco, Tunisia, Nigeria and so on. Natural gas is available in Afghanistan, Bangladesh, Pakistan & Iran. Cotton is grown in Pakistan, Yemen, Syria, Egypt, Sudan, Syria, Tanzania & Uganda. Bangladesh has jute, tea, fish. Pakistan & Egypt grow rice. Yemen, Tanzania and Uganda grow coffee. Nigeria grows cocoa and groundnuts. Phosphates are available in plenty in Morocco, Tunisia, Egypt, Jordan. Some of the Muslim countries are also rich financially. They are Kingdom of Saudi Arabia, Kuwait, U.A.E, Qatar, Brunei. Per capita income of these countries are higher than that of the U.S.A. They are known to be the richest countries of the world. This has been attributed to huge export of oil resource of these countries and very small population. The huge financial resources of these countries can be best utilised for the development of their own economy and economies of the other Muslim countries. Some of the Muslim countries (Indonesia, Bangladesh, Pakistan) of the world are very rich in terms of human resources but they are not blessed with financial resources. There are ample scopes of combining the natural resources, financial resources and human resources of Islamic countries for the advancement of the economy of all the Islamic countries. During last century, Muslim Countries achieved political independence, yet , this has been less meaningful, because they did not achieve economic salvation. Resources of the Muslim countries are being still exploited. The Islamic countries have been kept under strict control, supervision and guidance in such a way that they had been virtually denied any economic freedom and independence to build their destiny and realize their socio-economic objectives. In the recent past there has been a continuous awareness among the Islamic countries for coming close to one another for economic cooperation and increasing the ties and friendship and brotherhood through joint and united efforts in all their activities. Emergence of Takaful as alternate of conventional insurance system have paved the way in right direction for further cooperation among themselves.

5. **What role Takaful can play to the Muslim Ummah ?**

In the recent past, the Muslim world is being stirred with an endless enthusiasm and impetus to occupy its real place among the community of nations and contribute its due share and to its duties to humanity. Takaful is a service to Muslim Ummah (community) as a welfare scheme. Introduction of Takful is an example as to how the principles of Islamic Shariah can help to create new socio-economic mechanism based on equity, justice and fair play.The objective of Islamic Economy is to create an exploitation free society and upliftment of the entire society as a whole. The Takaful system, which has been working for the welfare of the mankind is not in contradiction with Islam. The objective of Islamic Economic system is the promotion of welfare of people which lies in safeguarding their faith, their life, their posterity and their property. By ensuring and safeguarding these elements of the people, Takaful serves public interest and, therefore, can play the most important role. An exploitation free society as Islam envisaged have provisions for adequate capital formation. The Prophet of Islam disapproved begging and encouraged capital formation. He advised a poor companion to sell all his belongings for purchasing an axe for collecting firewood and sell those in the market. The Takaful system will facilitate capital formation of individual households. This will motivate every individual for savings under Family Takaful and the collective surplus funds will be invested in the capital market. This will facilitate further utilization of resource and greater employments.

As the Islamic countries are likely to shun the venoms of nationalism and reap the fruits of Islamic Brotherhood, they should enhance trade among themselves. Islamic countries posses agricultural, industrial and financial resources. They need to exchange these resources through trade and commerce. General Takaful scheme will facilitate trade, commerce and best utilization of these resources. It is found that most of the Muslim countries are not self sufficient in all types of its required goods and services. This creates the root from which trade prospects among the Muslim countries stem. Material progress in full measures is desired by Islam. But on the other hand one main objective of Islam is to change and build up peoples outlook and values. This makes it possible to establish justice in economic matters. This can be achieved not only by applying laws only but also through voluntary socio-economic system. Takaful is considered as a socio-economic device through mutual cooperation and mutual complementarity as envisaged in Islam. The first policy of the Prophet(P.B.U.H) which was put into operation was the establishment of a brotherhood between emigress (Muhajirs) and inhabitants of Medina (Ansars). The Prophet encouraged both the Muhajirs and Ansars to engage in limited partnership. The Ansars owned the cultivated fields and the Prophet insisted that the Muhajirs engage in cultivation in these fields without assuming ownership right. Takaful mechanism encourage this kind of limited partnership as mode of investment. and can play a key role for the betterment of Muslim Society throughout the world.

6. How Takaful suits in Islamic Economy System ?

Islam is the second largest religion in the world with one and quarter billion followers. In all, Muslims form a majority of the population in over forty countries. Muslims live in 184 countries comprising about 20% of world population. Islamic countries and other countries with a significant Muslims in the recent past have encouraged the provision of financial services, including insurance, under Islamic principles. As a result more than sixty Takaful/Islamic Insurance companies have been established for providing insurance coverage both in the life and non-life sectors. These insurers generally known as Takaful operators are found not only in Islamic countries but also in Europe, North America and Australia. This type of modified insurance mechanism is expected to further influence the supply of and demand for insurance in the Muslim community. Takaful has grown not only as an innovative financial instrument, but also on religious principles. The purpose of religion is the well being of mankind. Islam as a religion seeks to order human life so as to make it actualise the pattern intended for it by its Creator. Islam is not only a religion but an ideology in the sense that the Shariah, its law has given the Muslims a pattern of life with which to order their lives. The Shariah is comprehensive, embracing all human activities, defining man’s relations with God and with his fellow men. The Shariah grew out of the attempts made by early Muslims as they confronted immediate social and political problems to devise a legal system in keeping with the code of behaviour called for by the Quran and the Hadith. The purpose of Islam is always to inject morality into the fabric of human relations. How the Muslims earn its livehood, how he spends his wealth and how his wealth is to be disposed of after his death all these are the stuff of Islam. In Islam, the human aspect is more important than the material one. It relies more on moral, ethical and human aspects than on the material aspects. This is something unique in the Islamic Economic system.

Prophet Mohammad said,

“ One who eats to his hearts contents, while his neighbor starves, is no a Mumin“

Helping neighbours, poor relations and the distressed contribute to an exploitation free society based on the principle of brotherhood . Understanding fundamental principles of Islamic Economic System is necessary in order to have a better understanding of the role of Takaful and its suitability in the Islamic Economy. For example, right of private ownership accorded by Islam is not absolute and unconditional The ownership is a kind of trust only. An individual may privately own and manage any kind of wealth, but he can not do with them whatever he likes. He is to regulate the uses as per the Shariah Law. An individual can make joint investment to earn profit from his investment. Takaful is a means whereby investments of surplus funds are made by the Operators and profits are distributed to the Participants i.e. to the owners of the capital. Another fundamental principle of the economic system of Islam is that it stands for equitable distribution of wealth. Islam encourage people to be selfless helpers for one another by arousing in them feelings of sympathy. Takaful is a system where people are encouraged to contribute money for mutual help in times of need. Thus Takaful comes in for help of distressed fellow by means of mutual cooperation and joint guarantee. The Islamic Economic system combats the accumulation of wealth and its concentration in the hands of a small minority. The Islamic Law of inheritance provider for the shifting and distribution of wealth in a manner unknown in other legal and economic systems. It divides the estate of the deceased over a wide range of beneficiaries and not on a single heir to the exclusion of other. The nominee in a family takaful scheme is only a trustee and the policy money need to be distributed to all the heirs. The Islamic system requires that wealth should be utilised as an instrument to serve the interest of the community at large. In the Islamic way of life, some special kind of levies are imposed. The objective behind them is to provide financial assistance to the people of lower income bracket from the money of the relatively better off people. In Islam, there are a various kinds of compulsory levies ranging from very high rate of 20% of the income to the minimum of 2.5% of income. These are to be collected from the poor and needy. This is an automatic mechanism of balancing income in the society. Islam makes it obligatory on every Muslim who possesses a certain limit of income upto one year to pay a certain percentage of it for the destitute and needy. This is called Zakah. It is so important part of Islam that the instruction of the payment of Zakah always comes next to Salat (prayer). The prophet described Zakah to be one of the five pillars of Islam. The Takaful companies which create fund to meet unforeseen loss of individual and also the contributions and donations made by the Participants in a Family Takaful Scheme become Zakatable asset. Takaful Operator, therefore must arrange payment of Zakah out of these funds for the poor and the needy. There are broadly eight heads of expenditure of Zakah each of them include people in need of financial assistance. All the poor and destitute temporary or permanent are covered by the financial assistance system of Zakah. Takaful system, therefore, not only provide security for the people who participates in the schemes of Takaful but it is also a means for providing financial assistance to the needy people of the community and a mechanism of obligatory social security. Zakah is of course not a substitute of income tax. It is imposed on capital. Zakat has to be levied annually whether it is invested or not. Therefore, it is prudent for the owners and managers of the fund to invest it in production purposes. As a result, it induces that all the resources and wealth

of the economy are employed continuously in the productive activities. By implementing Zakah system within the mechanism of Takaful, it helps develop the economy towards growth and prosperity.

7. **How Takaful is beneficial ?**

It has been estimated that annual overhead cost of property insurers account for about 30% to 50% of their earned premium. This means a major portion of the premiums paid by the policy holders would be used for doing the business and earning profit for the shareholders. Therefore, it is obvious that the insured and the society obtain the benefits of insurance jointly against the cost of obtaining this service. However, it can be seen that the cost of operating the takaful business will be comparatively lower under the Islamic system. It is well understood that when the surplus (profit) is shared by the policy holders, the cost of obtaining the service would be lower in the Islamic Insurance (Takaful) system at least to the extent of surplus fund being returned to the policy holders. Moreover, the insureds in the conventional companies are to bear the costs for losses which are intentionally caused and or exaggerated. Although, there are no reliable estimates as to the extent of losses that are intentionally caused, it is obvious and insurers are well aware that good amount of claims are being paid against losses which are intentionally caused by some unscrupulous insureds in order to collect on their policies. It is also observed that there is the tendency to exaggerate the extent of damage and losses that results from purely unintentional loss occurrences. There are a lot of examples. When it is known that an insurance company is involved there seems to be an unmistakable tendency to exaggerate the extent of loss by surveyors, repairers, medical practitioners, solicitors as the case may be. This is done in collusion with the dishonest insureds. It is expected that the costs of exaggerated and intentional losses would be much lower, if any, under the Islamic insurance system. This is mainly because there would be insureds under this system are those God-fearing individuals who want to lead an honest life and as such should not indulge to such unfair and unethical practices for the temporary gains in the worldly affairs. Since, the Islamic insurance companies will be basically operating on the principles of "Mutuality" it is very logical that the net underwriting gain of Islamic Insurance companies will be higher compared to corruption prone conventional insurance.

8. **How Takaful came into being in Malaysia ?**

In the early eighties, Malaysia legitimised the operation of Takaful companies with enactment of the Takaful Act by the parliament, vesting with the Central Bank of Malaysia, Bank Negara, the authority to regulate the Islamic insurance industry and to monitor the compliance of companies with the letter of the law. Syarikat Takaful Malaysia Sendivian Berhad, STMB, a subsidiary of Bank Islam Malaysia Berhad was the first to obtain a Takaful operation license in Malaysia under the new Act. It was incorporated on 29 November 1984 with an authorized capital of RM 100 million and a paid-up capital of RM 10 million, and commenced its operation 8 months after its incorporation. Since its establishment, STMB has been actively involved in Islamic Life Insurance-Family Takaful-and General Takaful, each with its own unique characteristics. The aim of the General Takaful Scheme is to provide compensation in case of accidents, much like any conventional insurance fund. The difference is the mutual nature of the fund where the source of funds for any claim settlement with an insured is the

contributions made to the fund by other participants. Upon receipts of premium payments, STMB acts as trustee to invest the moneys in acceptable opportunities and to channel back into the fund the returns on the investment less the operating costs. After settling all the claims, any residual amount will be distributed between STMB and the participants based on a previously agreed-upon ratio. The coverage period under this scheme is shorter than the Family Takaful Plan. In attempts to promote greater competition, possibly leading to a wider selection of Islamic insurance products as well as lower premiums. A second license was issued to MNI Takaful Sdn Berhad to operate Islamic Insurance in Malaysia. Eighty percent of the shares of the new company are owned by Malaysia National Insurance Sdn Berhad, the largest local insurance company. As the public may have the misconception that there are few differences between STMB and MNI Takaful, and since STMB has already been well established in the Takaful market, MNI had to find ways and means to highlight its uniqueness. The marketing strategies of MNI Takaful was to increase public awareness of Takaful, to make Takaful more accessible to its customer at "any time, any place, anywhere," to utilize the technological means in meeting their objectives faster, and to establish cooperative efforts with other financial institution in promoting Takaful. it has, assembled a strong marketing force and sales executives, as well as a highly motivated group of agents. The company has also explored other channels-banks and the posts offices, for example - to reach potential customers. At present there are several other takaful operators. They are basically following the Mudarabah model of Islamic Insurance. Some of there are practising Takaful operation as Wakal Model, whering reasonable service charges are being borne by the participants.

9. **How Takaful was launched in Singapore ?**

A 1990 convention to launch the Association of Muslim Professionals (AMP) was probably one of the first occasions when the idea of Islamic insurance was brought to the attention of Singaporeans. Together with Islamic banking, Islamic insurance was viewed to not only promote the economic development of the Muslim community in Singapore, but also to help Singapore's aspiration to be a front-runner in the race for financial market superiority in the region. Five years later, in September 1995, Islamic insurance was officially launched by two separate Muslim groups-A joint venture consisting of Ampro Holdings Singapore and NTUC Income, as well as another cooperation between the Singapore Malay Teachers' Multi-Purpose Cooperative Society (SKSGMS) and Keppel Insurance. The Ampro-Income tie-up is targeting, as its primary market, the 15% percent Muslims of 3 million Singaporeans. The main aim of this tie-up is to ensure that Muslims in Singapore are provided with means to obtain insurance coverage that does not compromise their religious beliefs. The reasons why NTUC Income was chosen for this cooperation, and not the others, may be the company's relatively large number of Malay insurance agents, and the fact that NTUC Income is not an only-and-all revenue generating entity. Keppel Insurance whose products are marketed through a cooperative subsidiary set up with paid-up capital of $ 500,000, on the other hand, acts only as an underwriter in their endeavour with SKSGMS. While Ampro emphasizes its Takaful Fund as its single product, Keppel prefers to offer a wider spectrum of products, ranging from Group Family Takaful to whole life insurance to endowment and other investment-linked products. Their strategy is to invest about 75 percent in Singapore's more stable and mature stock market and 25 percent in Malaysia. One common type of

Islamic insurance instrument currently available to the 18-65 years olds in the Singapore market is the Family Takaful Fund which combines the life insurance element of Family Takaful with a direct investment scheme. Here, in addition to the fundamental objective of promoting a more equitable and just position among the parties involved through its profit-sharing program, policyholder's family members are provided with financial support in the event of unfortunate accidents. In order to comply with the Shariah, policyholders are informed on how their money is used, where the source of the profits are, and also how the profits are shared. To join the scheme, a minimum single-premium contribution of $ 4,000 must be paid, either in cash or from the policyholders' retirement account Central Provident Fund (CPF). The amount of coverage expands as premiums contribution increases, and the holders of the policy may choose to take up any of the supplementary benefits-Permanent Total Disability, Personal Accident, and Hospitalisation. The maturity of the policy varies from 10 to 40 years, and the premiums received are guaranteed to be invested in halal stocks-those of businesses that do not violate the Shariah. The profits generated from such investment activities are distributed among policyholders as bonuses. Policyholders may surrender parts of the units under their name at any time, or may purchase additional units if they so desire.

10. How Islamic Insurance has grown in Indonesia ?

In May 1995, the (then) Minister for Research and Technology B.J. Habibie officially declared PT Asuransi Takaful Umum operational as the first Islamic institution to provide general insurance. In February 24, 1996, PT Syarikat Takaful Indonesia was set up as a holding company for PT Asuransi Takaful keluarga's life and PT Asuransi Takaful Umum's general insurance operations. PT Asuransi Takaful Keluarga is the only Islamic life insurance company, among Indonesia's one state-owned, 37 privately owned, and 16 joint-venture life insurance companies. Following its inception, PT Asuransi Takaful Umum set its goal to reach a premium target of Rp 3 billion by the end of 1995. The first Director of PT Syariakat Takaful Indonesia, Rachmat Husen, thought this would be possible in just six months Asuransi Takaful Umum should have the capability to collect that amount of premiums. In early December 1995, having been entrusted an American oil company to manage their insurance fund, Takaful Umum not only achieved its the premium target on time, but surpassed it at Rp 3.19 billion. By December 1996, PT Asuransi Takaful Umum's gross premium increased by 34% to Rp 4.30 billion. The company recorded an increase in pretax profits of 188.21 percent amounting to Rp 758 million as of December 1996 from Rp 263 million per December 1995. PT Asurani Takaful Keluarga, similarly, experienced a large increase of 207.41 percent in life insurance and annuity premiums-from Rp 3.24 billion as of December 1995, to Rp 9.96 billion by December 1996. In terms of profits, however, this company did not perform as well as ATU-it showed a deficit of Rp 409 million in December 1995 and Rp 923 million in December 1996. Despite the losses, in terms of membership, PT Asuransi Takaful Keluarga Currently ranks 13th among the 56 registered life insurance companies with the Dewan Asuransi Indonesia (DAI). The Indonesian Takaful industry has further spread its market base by penetrating the oil and gas industries, which traditionally have been monopolized by Pertamina owned insurance companies. It has established ties and cooperates with various Islamic organizations, such as Muhammadyah and Nahdlatul Ulama whose combined

member are totalling more than 40 million. The market is not fully tapped yet and the Takaful industry is set to grow further in Indonesia.

11. **What efforts have been taken for Islamizing Insurance in Pakistan ?**

Insurance contract is an important contemporary issue which has attracted the attention of Shari'ah scholars and Islamic economists. In Pakistan many scholars wrote articles and books regarding the Islamic status of insurance business. But very little work has been done on the alternative system of insurance which should be satisfying the Islamic principles and objectives. Only two efforts are known by now, one is by Mufti Muhammad Shafi, an eminent Shariah scholars and other is by Council of Islamic Ideology of pakistan. Mufti Muhammad Shafi, while responding to a questionnaire from Majlise-e-Tahqiqat Shariya Lucknow in 1964, not only analysed the existing insurance business but also proposed an alternate model of Islamic Insurance. The Council of Islamic Ideology (CII) Pakistan reviewed the existing insurance practices and suggested an Islamic alternative. The council examined the laws governing the insurance business in the country in 1984. It analysed eleven such clauses and expressed its opinion about them in a brief report to the government, which was in March 1984. The council further decided to constitute a working group to analyse the existing system and frame a new system of surety and assurance in accordance with the Islamic teachings. The working group includes besides the Ulama members of the council, economists, the heads of the government insurance companies and other insurance experts. The working group prepared a preliminary report on insurance, but due to the expiry of the tenure of the council, this effort was discontinued.In 1990 a new council came into existence which decided to form another group to complete this task. The working group comprised of six mmebrs of the council and four representatives of major insurance corporations. The group also benefited from the expertise of around twenty scholars and insurance experts to understand the nature and functioning of the present system and to develop an alternate system. The group prepared a report in 1992 and submitted for consideration by the government. In this report the group reviewed the history of insurance and its present forms. It also looked into the status of insurance from Shariah point of view and found that in its present form it involves the elements of Riba, speculation and gambling. The group also has reviewed the functioning of Islamic insurance (Takaful) companies, working in different Muslim countries, for developing a practical model for Islamic Insurance and suggested an alternate system based on the concept of Mudarabah and Waqf. But no practical step has been yet taken for the Islamization of insurance.

12. **What is the potentiality of Takaful Industry ?**

In the contemporary Islamic countries role and importance of Takaful has not been duly recognized by the policy makers. Even the growth of conventional insurance is not very satisfactory. If we look into the present scenario of the insurance sector of the D-8 member countries, we find a dismaying picture. The following tables show insurance density of D-8 member countries and middle east oil rich countries.

TABLE-A

INSURANCE DENSITY OF D-8 ISLAMIC COUNTRIES

ountry	Population (million)	Per capita GDP	Per capita Premium		Total
			Non-Life	Life	
Bangladesh	135	$ 1,260	$0.6	$0.7	$1.3
Egypt	65	$ 2,900	$ 9	$ 2	$ 11.0
Indonesia	210	$ 3.770	$ 8	$ 6	$ 14.0
Iran	68	$ 5,200	$ 23	$ 3	$ 26.00
Malaysia	23	$ 10.750	$ 62	$ 78	$ 140
Nigeria	107	$ 1,380	$ 7	$ 1	$ 8
Pakistan	132	$ 2,300	$ 2	$ 1	$ 3
Turkey	64	$ 6,100	$ 21	$ 4	$ 25

TABLE-B

INSURANCE DENSITY OF MIDDLE EAST ISLAMIC COUNTRIES

Country	Population (million)	Per capita Premium		Total
		Life	Non-Life	
UAE	2.6	$ 58	$ 252	$ 310
Qatar	0.6	---	$ 260	$ 260
Lebanon	4.3	$ 19	$ 93	$ 112
Kuwait	2.1	$ 16	$ 77	$ 93
Oman	2.5	$ 14	$ 52	$ 66
Saudi Arabia	20.5	$ 0.6	$ 37.5	$ 38.1
Syria	15.8	$ 0.1	$ 16.5	$ 16.6

If we compare insurance density of these Islamic countries with that of other leading countries of the world, we can understand where do we really stand. For example, in South Africa share of insurance premium to GDP is more than 20% in comparison to 3.5% in Nigeria. In Bangladesh insurance penetration is less than 1%, whereas in Japan premium per capita is approx US $ 3900 and in Malaysia it is approx US $ 140 and in Bangladesh it is less than $ 2.00 (two) only. This means, there are ample scopes of growth of Insurance vis-à-vis Takaful in Islamic countries. Takaful market is bound to grow with the pace of the economy. The growth of the Takaful industry and economic development of these countries are interdependent. Although the demand for Takaful is a reflection of income and wealth, it is to be noted well that risk consciousness is very low in the Islamic countries. There is an urgent need to create a deeper understanding and awareness among the policy makers, what role Takaful can play to improve the well being and quality of life of the Ummah. Takaful has been designed to help and stabilize the financial situation of individuals, families and organizations. At the same time Takafukl operators can meet the financing needs of large projects,

thereby helping the national economies by enlarging the set of feasible investment projects and encouraging economic efficiency. Takaful will definitely help to foster a more efficient allocation of capital and resources of Islamic countries, by way of promoting trade, commerce and entrepreneurial activities. A growing Takaful and Retakaful market is an instrument for economic growth of the Islamic countries. In fact, the development of Takaful as an alternative of conventional insurance will contribute to economic prosperity of the Islamic countries. On the other hand, with the growth and development of the economy, the Takaful Industry will grow. It is obvious that Takaful is a suitable alternative of conventional insurance for the Muslims. But, the pertinent question is how best it can serve the needs of the community ? There is no doubt that Takaful has a vast potentional for growth and this potentionality will definitely increase in the coming years. However, the future of Takaful will largely depend on how the increasing potentials are being exploited by Takaful operating system, keeping in view the need of the Islamic economy and state of affairs in Islamic countries. Religion and culture of the Muslims are plus points for Takaful Operators. But, that is not all. Political and economic stability of the Islamic States, professional maturity of the Takaful Operators, ability of designing appropriate products and reducing management expenses including distribution cost are some of the important factors for influencing the demand of Family Takaful. The factors which will influence the demand of General Takaful are growth of trade, commerce & industry as well as risk potentials and their severity and frequency. Of courses, risk awareness is another important factor. The growth of both Family Takaful & General Takaful will depend on the marketing strategies, distribution net work and adoption of improved information technology. Last, but not the least, the supply of Takaful in the Islamic countries will depend mostly upon the support and sympathy of the policy makers. If the concept of Takaful is not properly understood, the legislators may not subscribe the idea of promoting Takaful and for that matter floating of Islamic companies under the Conventional Insurance Act will simply mislead the consumers. Since an effective regulatory system play a great role in the dynamics of supply, it becomes the responsibility of the Regulatory Authority of Islamic Countries to frame appropriate laws & rules for facilitating the growth of Takaful for the benefit of the community and of course for the growth of the economy as a whole. It is obvious that the interaction of demand and supply will determine the consumption of Takaful. The shift in demand for Takaful will occur as it is an innovative product and suits to the socio-economic & religious teachings of Islam. Moreover, the Islamic countries are likely to have economic growth both in the micro and macro level. However, the major increase in the consumption of Takaful will result from the increase in the supply of Takaful. The demand already exits. The extent to which it is tapped would depend on the extent to which the supply curve moves to the right.

13. **What about the future prospects of Takaful ?**

Currently, there are about sixty "takaful" operators world-wide. During last twenty years Islamic Insurance (takaful) has developed mainly in Sudan, Saudi Arabia, Iran, Malaysia, Brunei, Indonesia, Singapore, Bahrain, Bangladesh, Bahamas, Belgium, Switzerland, and in the USA. On the other hand, there are at present 45 countries, in the world having some form of Islamic banking operations. Interestingly takaful is seen in the non-Muslim world as well. For example, in Singapore there are less than half a million (15% of total population) Muslims

but at least two operators are now providing takaful scheme in Singapore. In non-Muslim countries, the scheme is also likely to grow if the operators can prove their worth in comparison to conventional insurance products. In Muslim countries, Malaysia seems to be the single most successful country in terms of takaful. In Singapore, about 22% of the present takaful policy holders are non-Muslims. Most of Islamic countries suffer from the common attitude that insurance is undesirable. There are mass non-awareness among the Muslim about risk management and insurance not to speak about takaful. In most of the Muslim dominated countries of the world insurance still accounts for less than only one percent of the country's G.D.P. However various surveys have shown that the life and general insurance market has large potential to be exploited in Muslim countries, and in countries where Muslim are at-least 10% to 15% of total population . Takaful is likely to grow along with the conventional insurance schemes. But this is only when this new form of insurance should provide at-least equal, and better value, as compared to the existing conventional insurance policies.

14. **Is Takaful a viable reality ?**

By now Takaful like Islamic Banking has become a viable reality. Due to inherent Shariah principles which are universal in character, the Takaful business would be more appealing in the coming years for both the Muslim and non-Muslim communities. Takaful (Islamic Insurance) has bright prospects and potentialities as a financially viable and competitive alternative insurance for the Muslim Countries, because most of the Muslim Countries having Islamic Banks have also welcomed takaful as a necessary complementary to Islamic Banking. Islamic Banking can not be fully Shariah based unless there is Takaful to take their insurance business. Therefore, Takaful like Islamic Banks have proved its viable reality and having its strides of expansion in almost all the Muslim Countries. The confidence and faith of Muslim Countries in Islamic economic system is gaining solid ground. Recently the Heads of States and Governments of Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey met in Dhaka on 1-2 March, 1999 for the Second D-8 Summit with the objectives of implementing projects and programmes of co-operation that are of vital interest to their peoples. Among other issues, the heads of the State endorsed the proposal to enhance the capacity of existing retakaful company of Malaysia to meet the needs of member countries of D-8. It was further agreed that the experts of these countries will meet to draw-up the modus-operandi and formulate the appropriate strategies to promote takaful and retakaful. It is heartening to note that takaful operators are organising seminars and conferences on a regular basis and exchanging ideas and information's to make takaful viable.

15. **What is the Role of Government in Islamization of Insurance System ?**

Government is to perform an active role in Islamization of insurance in the country. Islamization may take place in two ways. The first way is to restructure the whole insurance sector on Islamic foundations and the second is to allow some Islamic insurance companies or some old firms to transform their business on Islamic lines keeping the existing set-up as it is. These two approaches require different strategies on part of the government.

In the former case, the government may promulgate a regular detailed and codified law to reorganise the insurance industry in line with Shari'ah principles. This law should reflect the true spirit of mutual help and co-operation. All the

elements making the present insurance practices un-Islamic (e.g. interest, gambling, gharar) should not be allowed in any circumstances. Some Islamic countries such as Malaysia and Sudan, have already enacted such laws which can be used as guiding examples. However if the government opts the later approach, then it must make suitable changes in the existing Insurance Act to create favourable environment to new companies to be established on Islamic principles. Some laws are hurdle for running the business according to Islamic principles. Moreover the government must facilitate and encourage these companies providing them incentives such as tax exemptions in early period of establishment. This may help the existing conventional insurance companies to restructure their business on Islamic lines. A time frame may also be decided by the government for complete transformation of conventional Insurance business into Islamic Insurance. Another function which the government should perform is reinsurance arrangement. Presently insurance companies, are having two kinds of re-insurance arrangement, (I) with the Sadharan Bima Corporation, (ii) with foreign insurance companies. In both of these arrangement, the insurance company enters into a similar type of contract with the re-insurer, as one between an individual and the insurance company, including all un-Islamic element of insurance. Government is arranging reinsurance through Sadharan Bima Corporation in the existing set-up. For extending this service to the Islamic insurance companies government may establish a Fund, and all Islamic insurance companies should contribute a proportion of their written premium in this Fund. This proportion may be different for different policies. The objective of this fund should be to help the insurance companies in paying the claims. A proportion of this fund may be invested in profitable ventures according to Islamic principles and profit can be shared between the fund and the insurance companies.

16. **What are the hindrances of Islamic Banking & Islamic Insurance ?**

Banking and Insurance are the two fundamentals of modern trade & commerce. Banking provides safeties to the depositors and plays a vital role for development by financing the surplus fund to the deficit groups. On the other hand, Insurance provides safeties for the people as security against accident, calamities and pathetic situation. Modern trade and commerce can not be conceived without involvement of Banking and Insurance. But, the conventional system of Banking and Insurance, which are based and linked up with interest, can not be adopted by the Muslims as a Shariah compatible system. But, trading and equity financing as well as the principle of compensation and group responsibility are widely accepted in Islam. Further, there is an intrinsic and inherent relation between Islamic Bank and Islamic Insurance. It is a precondition for the success of Islamic Bank to cover its risk by a system accepted in Islam. This is possible by adopting the system of Islamic Insurance. On the other side, progress of Islamic Insurance depends on a healthy growth of Islamic Banking. Due to inherent Shariah principles which are universal in character, the Islamic Banking and Takaful business would be more appealing in the coming years for both the Muslim and non-Muslim communities. There is tremendous possibility for the growth of Islamic Banking and Islamic Insurance. But, there is still lot of problems and hindrances to run the Islamic Bank and Islamic Insurance, some of which are as under:

1. Absence of appropriate legal framework for carrying out Islamic Banking and Insurance operations in most of the Islamic countires.

2. Shortage of trained manpower to conduct business complying Shariah.
3. Absence of Shariah based securities.
4. Shortage of support institutions.
5. Absence of good relationship among the Management, entrepreneur and the Controlling & Legislative Authority.
6. Lack of public awareness.
7. Ignorance of the mass people about Shariah principles and practices in business & commerce.
8. Pre-dominance of Secular Western Capitalistic Economic System.
9. Lack of support from Government mechanism .

17. **How Islamic Bank and Insurance companies can cooperate for mutual growth and expansion ?**

Islamic Banks have already attained considerable success in the Banking sector. It is just beginning of Takaful business and it is likely to flourish in the Insurance sector in coming days. To attain the desired level by both the Islamic Bank and the Islamic Insurance, a strong relationship need to be built up between the Islamic

Bank and the Islamic Insurance throughout the world. **The following actions may be taken jointly by the Islamic Banks and Islamic Insurance Companies for their mutual growth and expansion and to face the challenges :**

1. Efforts should be made to change the legal framework for conducting banking and insurance operations according to Islamic Shariah.
2. Sufficient training and research institute having logistics of modern technology may be established to train up the manpower.
3. To create public awareness; seminar, symposium etc. both national and international level may be organised.
4. Islamic Money & Capital Market should be developed.
5. Central Shariah Council should be set up both for Islamic Banks and Islamic Insurances.
6. Like Malaysia, both the Islamic Banks and Islamic Insurance Companies should be regulated by the same Regulatory Authority, L.I.C the Central Bank.
7. Cordial and harmonious relationship between Islamic Banks and Islamic Insurance Companies should be developed.
8. Efforts should be made to establish more Islamic Insurance Companies and Islamic Banks.

Islamic Banking and Islamic Insurance system have tremendous potentiality and prospect. The successful launching and operation of Islamic banks insurance has established the fact that banking and insurance without interest is feasible, viable, competitive and sustainable on the face of competition from the conventional secular system. The gradual and successful globalisation of Islamic Banking and Islamic Insurance coupled with growing awareness of the people about its

financial and social benefits makes it clear that the current century is going to be the century of Islamic banking and insurance vis-a-vis complementation of Islamic ideals for the betterment of the people at large and establishing equity & justice for all.

18. **How Islamic Insurance can supplement the transactions of Islamic Banks ?**

Commendable performance of Islamic Banks has established the fact that interest-free financial institutions are very much feasible and necessary. Therefore, interest-free Islamic Insurance Company is urgently required to supplement and support the activities of the Islamic Banking system. With the formation of Islamic Insurance Company, millions of people who are now not participating in insurance under the conventional system can be brought under the fold of Islamic Insurance system. Thousands of small, medium and large traders, entrepreneurs and industrialists will come forward to insure their properties through Islamic Insurance Company. This will lead to a further expansion of the insurance market in a new expansion of the insurance market in a new dimension and thus will help towards further growth of the capital market of the country. Although an Islamic Insurance Company will be registered under the Companies Act, the principle of mutuality will be the fundamental operating principle of the company. Therefore, it is likely that the insurance covers will be provided at the actual cost. Since risks will be covered more economically, the people will be getting the services at a lower cost. Further, an Islamic character, will establish "Jakat Fund" and will initiate welfare oriented rehabilitation programmes for the poor. This will help to alleviate poverty in the Islamic countries. The first ever Islamic Insurance Company was established in Sudan in 1979 and the entire capital of the company of Sudan enjoys numerous concessions and exemptions. In Malaysia, the Islamic insurance company known as the Syriaket Takaful Malaysia started its operation in 1985. The company was established by the direct initiative of the Malaysian Government as a subsidiary of Bank Islamic Malaysia Berhad which owns 51% of the paid up capital of the company. The balance 49% of the capital are owned by the various State Religious Councils and State Religious Foundations of Malaysia. One of the prime objectives of Islamic Bank is to offer contemporary financial services in conformity with Shariah and for that matter to undertake financial activities which are ethical, socially desirable and profitable, so that the bank can contribute towards economic development and prosperity of the mass. By establishing a subsidiary Islamic Insurance Company, Islamic Banks will be achieving their ultimate goal i.e. establishment of economic and social justice by way of even distribution of wealth in the society, instead of accumulation of wealth in few hands. For obvious reasons, Islamic Banks have been following a line of least risk and assured success. Naturally, the banks insist on collaterals against credit. However, due to non availability of services of "Islamic Insurance", they are to use the services of conventional insurance companies to cover risks of their assets, including investments and collaterals. With the establishment of Islamic Insurance Company, the Islamic Banks will be able to avoid interest-based insurance, which is forbidden in Islam.

19. **Is there any move to foster the growth of Takaful ?**

By now Takaful like Islamic Banking has become a viable reality. Due to inherent Shariah principles which are universal in character, the Takaful business would be more appealing in the coming years for both the Muslim and non-Muslim communities. It is no denying of the fact that Takaful (Islamic Insurance)

has bright prospects and potentialities as a financially viable and competitive alternative insurance for the Muslim countries. Most of the Muslim countries having Islamic Banks have also helped to create takaful as a necessary complementary to Islamic Banking because Islamic banking can not be fully Shariah based unless there are Takafuls to take their insurance business. Takaful like Islamic Banks have proved its viable reality and having its strides of expansion in almost all the Muslim countries. The Governments of these countries ought to have strategic policies to promote and foster the growth of Takaful. The confidence and faith of Muslim countries in Islamic economic system is gradually gaining solid ground. Time has over run for all to go for Takaful business earnestly and seriously. It is heartening to note that the Heads of States and Governments of Bangladesh, Egypt, Indonesia, Iran, Malaysia, Negeria, Pakistan and Turkey met in Dhaka on 1-2 march, 1999 for the Second D-8 Summit with the objectives of implementing projects and programmes of co-operation that are of vital interest to their peoples. Among other issues, the heads of the State endorsed the proposal to enhance the capacity of existing retakful company of Malaysia to meet the needs of member countries of D-8 . It was further agreed that the experts of these countries will meet to draw-up the modus-operandi and formulate the appropriate strategies to promote takaful and retakaful. It is expected that the D-8 and OIC countries will co-operate for accelerating the growth of Takaful in the coming decades.

20. How Takaful can be made popular ?

Currently, there are about seventy “takafukl” operators world-wide. During last twenty years Islamic Insurance (takaful) has developed mainly in Sudan, Saudi Arabia, Iran, Malaysia, Brunei, Indonesia, Singapore, Bahrain, Bangladesh, Sri Lanka, Bahamas, Belgium, Switzerland and in the USA. On the other hand, there are at present 45 countries, in the world having some from of Islamic banking operations. Interestingly takaful is seen in the non-Muslim world as well. For example, in Singapore there are less than five lacs (15% of total population) Muslims but at least two operators are now providing takaful scheme in Singapore. In non-Muslim countries, the scheme is also likely to grow if the operators can prove their worth in comparison to conventional insurance products. In Muslim countries, Malaysia seems to be the single most successful country in terms of takaful. In Singapore, about 22% of the present takaful policy holders are non-Muslims. Most of Islamic countries suffer from the common attitude that insurance is undesirable. There are mass non-awareness among the Muslims about risk management and insurance not to speak about takaful. In most of the Muslim dominated countries of the world insurance still accounts for less than only one percent of the country’s G.D.P. However various surveys have shown that the life and general insurance market has large potential to be exploited in Muslim countries, and in countries where Muslim are at-least 10% to 15% of total population. Takaful is likely to grow along with the conventional insurance schemes. But this is only when this new form of insurance should provide at-least equal, and better value, as compared to the existing conventional insurance policies. With the growth of Islamic Insurance companies it would serve as the vehicle of risk management process and provide means of investment and project financing of respective countries. But there is a marked absence of Islamic insurance in almost all Muslim countries mainly because of non-awareness. Therefore, there is the need to educate the Muslim population on the importance of insurance and on the availability of insurance product conforming to the needs

of Muslims, on the basis of Sharial Law. There has to be coordinated and concerted efforts of all concerned in the Society to make Takaful popular.

21. **How the superiority of takaful can be enhanced?**

It has been estimated that annual overhead of property insurers account for about 30% to 50% of their earned premium. This means a major portion of the premiums paid by the policy holders would be used for doing the business and earning profit for the share holders. Therefore, it is obvious that the insureds and the society obtain the benefits of insurance jointly against the cost of obtaining this service. However, it can be seen that the cost of operating the insurance business will be comparatively lower under the Islamic system of insurance. It is well understood that when the surplus(profit) is shared by the policy holders, the cost of obtaining the service would be lower in the Islamic Insurance (Takaful) system at least to the extent of surplus fund being returned to the policy holders. Secondly, the insureds in the conventional companies are to bear the costs for losses which are intentionally caused and or exaggerated. Although there are no reliable estimates as to the extent of losses that are intentionally caused, it is obvious that insurers are well aware that good amount of claims are being paid against losses which are intentionally caused by some unscrupulous insureds in order to collect on their policies. Thirdly, there is the tendency to exaggerate the extent of damage & losses that results from purely unintentional loss occurrences. there are lot of examples. When it is known that an insurance company is involved there seems to be an unmistakable tendency to exaggerate the extent of loss by surveyors, repairers, medical practitioners, solicitors as the case may be. This is done in collusion with the dishonest insured. It is expected that the costs of exaggerated and intentional losses would be much lower, if any, under the Islamic insurance system. This is mainly because the would be insureds under this system are those God-fearing individuals who want to live an honest life and as such should not indulge to such unfair and unethical practices for the temporary gains in the worldly affairs. Further, it has been experienced that even in the western world the performance of mutual insurance companies when compared with stock companies in terms of net underwriting gain is better because of lower loss ratio and lower overhead expenses. Since, the Islamic insurance companies will be basically operating on the principles of “Mutuality” it is very logical that the net underwriting gain of Islamic insurance Companies should be better in comparison to conventional insurance companies. Although a rosy picture of an Islamic Takaful Company has been drawn on the basis of better underwriting results, it must be remembered that the financial success of the company depends on the following factors:

a) Soundness of the management of the company

b) Adequacy of reserves for all undischarged liabilities.

c) Soundness of investment of the company fund.

This means that Islamic Takaful company ought to be managed by qualified and professional people. In fact, so far the business efficiency is concerned, there is no substitute of professionalism. In case of Takaful companies the executives and managers must be motivated to the idealism and philosophy of Islamic system of insurance. Professional ability when backed by idealism, is sure to produce the very best results. In reality the human resource of the Takaful company will play the key role for its success and superiority over the conventional system.